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United States

Circuit Court of Appeals

For the Ninth Circuit.

Vol
2375

MINNIE L. WHITTHORNE and EVA WHIT-
THORNE, Executrices of the Estate of W. R.
Whitthorne, deceased,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent,

and

SHERWOOD SWAN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of the Record

Upon Petitions to Review Decisions of the
United States Board of Tax Appeals

FILED

JUL 18 1942

PAUL W. O'BRIEN,
CLERK

United States

Circuit Court of Appeals

For the Ninth Circuit.

MINNIE L. WHITTHORNE and EVA WHIT-
THORNE, Executrices of the Estate of W. R.
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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

	Page
Answer #101189	28
Answer to Second Amendment to Petition #101189	37
Answer #101190	62
Answer to Second Amendment to Petition #101190	74
Appearances #101189	1
Appearances #101190	5
Certificate of Clerk to Transcript of Record.....	225
Decision #101189	91
Decision #101190	92
Docket Entries #101189.....	1
Docket Entries #101190.....	5
Findings of Fact and Opinion #101189 and #101190	76
Opinion	85
Order of Substitution #101189.....	37
Order Re Consolidation.....	224
Order Re Preparing Single Record.....	226
Petition #101189	8

Index	Page
Petition #101189, First Amendment to.....	27
Petition #101189, Second Amendment to.....	31
Petition #101190	39
Petition #101190, First Amendment to.....	60
Petition #101190, Second Amendment to.....	65
Petition for Review #101189.....	93
Petition for Review #101190.....	99
Review:	
Petition for #101189.....	93
Petition for #101190.....	99
Statement of Points on.....	227
Statement of Points on Review.....	227
Stipulation Re Preparing Single Record.....	226
Stipulation Respecting Transcript.....	223
Testimony	105
Exhibits for Petitioner:	
1—Letter dated March 14, 1930 to J. F. Carlston from Oscar L. Cox.....	185
2—Letter dated March 15, 1930 to Oscar Cox from J. F. Carlston.....	187
3—Letter dated September 16, 1930 to Central National Bank from Oscar L. Cox	188
4—Letter dated April 22, 1931 to Sherwood Swan from Harrison S. Robinson	190

Index	Page
Exhibits for Petitioner (cont.):	
5—Letter dated April 24, 1931 to Harrison S. Robinson from Oscar L. Cox.....	195
6—Letter dated May 20, 1931 to Sherwood Swan from O. L. Cox.....	196
7—Letter dated June 1, 1931 to Sherwood Swan from O. L. Cox.....	198
8—Letter dated August 12, 1931 to Sherwood Swan from Harrison S. Robinson	200
9—Description of Real Property of Sherwood Swan and Company, Ltd. Held in December, 1936.....	201
10—Statement of Assets and Liabilities, Sherwood Swan	203
13—Petition for Authority to Compromise Indebtedness	205
14—Order Authorizing Compromise of Indebtedness	211
15—Certificate of Matt Wahrhaftig.....	213
17—Letter dated December 31, 1930 to David Wasserman from W. R. Whitthorne and Sherwood Swan With Promissory Note Attached.....	217
19—Consolidated Balance Sheet of Sherwood Swan & Company, Ltd. and Subsidiaries as of December 31, 1936.....	219

Index	Page
Exhibits for Petitioner (cont.):	
20—Check dated July 1, 1937 in the Amount of \$423.64 Payable to Collector of Internal Revenue from Sherwood Swan and Company, Ltd.....	220
21—Calculation of Present Value of Non-interest Bearing Note to Central National Bank dated December 16, 1936	221
22—Allocation of Cost Basis of Sherwood Swan & Company, Ltd. Old Stock Entirely to New Class A Shares December 21, 1936.....	222
Witnesses for Petitioners:	
Field, Edward B.	
—direct	136
—cross	138
Foley, U. R.	
—direct	171
Kittrelle, R. W.	
—direct	133
—cross	135
Robinson, Harrison S.	
—direct	105
—cross	109
Short, Frank G.	
—direct	162
—cross	170
—recalled, direct	172

Index	Page
Witnesses for Petitioners: (cont.):	
Swan, Sherwood	
—direct	122
—recalled, direct	138
—cross	154
—redirect	160
—recross	161
—recalled, direct	175
—cross	180
—redirect	183
Wainwright, James A.	
—direct	111
—cross	118
—redirect	121
Transcript of the Hearing at San Francisco, California, October 21, 1940 (See “Testi- mony”)	105

Appearances:

For Taxpayer:

ROBERT W. MACDONALD.

For Commissioner:

T. W. MATHER,

R. C. WHITLEY.

Docket No. 101189

W. R. WHITTHORNE (Amended title, order of
10/21/40), Estate of W. R. Whitthorne, De-
ceased, Minnie L. Whitthorne and Eva Whit-
thorne, Executrices,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1940

Jan. 16—Petition received and filed. Taxpayer no-
tified. Fee paid.

Jan. 16—Copy of petition served on General Coun-
sel.

Jan. 19—Amendment to petition filed by taxpayer.
1/19/40 copy served.

Feb. 15—Answer filed by General Counsel.

Feb. 15—Request for Circuit hearing in San Fran-
cisco filed by General Counsel.

1940

- Feb. 24—Notice issued placing proceeding on San Francisco calendar. Service of answer and request thereon.
- Aug. 13—Hearing set Oct. 7, 1940, San Francisco.
- Oct. 7—Order, withdrawal of Hillyer Brown and Chas. L. Barnard as counsel for taxpayer, and Robert W. Macdonald be substituted entered.
- Oct. 21—Hearing had before Mr. Sternhagen on merits. Hillyer Brown and Chas. L. Barnard allowed to withdraw. Robert W. Macdonald made counsel. Motion to substitute parties granted. Appearance of Robert W. Macdonald. Motion to amend petition. Second amendment to petition filed. Petitioner's brief due November 30, 1940. General Counsel December 31, 1940. Petitioner's reply January 20, 1941.
- Oct. 21—Order amending title to The Estate of W. R. Whitthorne, Deceased, Minnie L. Whitthorne and Eva Whitthorne, Executrices, entered.
- Oct. 31—Answer to second amendment to petition filed by General Counsel. November 1, 1940, copy served.
- Nov. 12—Transcript of hearing Oct. 21, 1940, filed.
- Nov. 29—Motion for extension to Dec. 12, 1940, to file brief filed by taxpayer. 11/29/40 granted.

1940

Dec. 11—Brief filed by taxpayer. 12/11/40 copy served on General Counsel. [1*]

1941

Jan. 11—Motion for extension of time to 1/22/41 to file reply brief filed by General Counsel. 1/13/41 granted.

Jan. 22—Motion for extension to Feb. 21, 1941, to file reply brief filed by General Counsel. 1/23/41 granted.

Feb. 20—Reply brief filed by General Counsel.

Mar. 3—Motion for extension to Mar. 25, 1941, to file reply brief filed by taxpayer. (1) Copies received 3/12/41. 3/5/41 granted.

Mar. 26—Motion for extension to April 4, 1941, to file reply brief filed by taxpayer. 3/26/41 granted.

Mar. 31—Reply brief filed by taxpayer. (Index to original brief also received.) 3/31/41 copy served on General Counsel.

Aug. 13—Findings of fact and opinion rendered, Sternhagen, #10. Decision will be entered under Rule 50. 8/14/41 copy served.

Sept. 9—Computation of deficiency filed by General Counsel.

Sept. 11—Hearing set Oct. 1, 1941, on settlement.

Oct. 1—Hearing had before Mr. Arundell on Rule 50. Not contested. Referred to Sternhagen for decision.

[*Page numbering appearing at top of page of original Reporter's Transcript.]

1941

- Oct. 2—Decision entered. Sternhagen, Division 10.
Dec. 26—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, filed by taxpayer, with affidavit of mailing.

1942

- Feb. 6—Certified copy of order and affidavit from the U. S. Circuit Court of Appeals, 9th Circuit, extending the time 30 days from Feb. 4, 1942, within which to file the certified record filed.
Feb. 12—Stipulation to omit certain portion of the reporter's transcript filed.
Feb. 27—Praecipe for record filed by taxpayer, with proof of service thereon.
Mar. 4—Certified copy of order from the 9th Circuit re consolidation and preparing single record filed.
Mar. 4—Certified copy of order and affidavit from the 9th Circuit extending the time 15 additional days from March 6, 1942, within which to file the certified record filed. [2]

Appearances:

For Taxpayer:

ROBERT W. MACDONALD.

For Commissioner:

T. W. MATHER,

R. C. WHITLEY.

Docket No. 101190

SHERWOOD SWAN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1940

Jan. 16—Petition received and filed. Taxpayer notified. Fee paid.

Jan. 16—Copy of petition served on General Counsel.

Jan. 19—Amendment to petition filed by taxpayer. 1/19/40 copy served.

Feb. 16—Answer filed by General Counsel.

Feb. 16—Request for Circuit hearing in San Francisco filed by General Counsel.

Feb. 23—Notice issued placing proceeding on San Francisco calendar. Answer and request served.

Aug. 13—Hearing set Oct. 7, 1940, San Francisco.

1940

- Oct. 7—Order, withdrawal of Hillyer Brown and Chas. L. Barnard as counsel for petitioner, and Robert W. Macdonald be substituted entered.
- Oct. 21—Hearing had before Mr. Sternhagen on merits. Hillyer Brown and Chas. L. Barnard allowed to withdraw. Robert W. Macdonald substituted as counsel. (Petitioner's motion to substitute parties in docket #101189) Petitioner's motion to amend. Second amendment filed at hearing. Petitioner's brief due 11/30/40. General Counsel's brief due 12/31/40. Petitioner's reply brief due 1/20/41.
- Oct. 31—Answer to second amendment to petition filed by General Counsel.
- Nov. 12—Transcript of hearing, Oct. 21, 1940, filed.
- Nov. 29—Motion for extension to Dec. 12, 1940, to file brief filed by taxpayer. 11/29/40 granted.
- Dec. 11—Brief filed by taxpayer. 12/11/40 copy served on General Counsel.

1941

- Jan. 11—Motion for extension of time to Jan. 22, 1941, to file reply brief filed by General Counsel. 1/13/41 granted.
- Jan. 22—Motion for extension to Feb. 21, 1941, to file reply brief filed by General Counsel. 1/23/41 granted.
- Feb. 20—Reply brief filed by General Counsel. [3]

1941

- Mar. 3—Motion for extension to March 25, 1941, to file reply brief filed by taxpayer (1). (Copies received 3/12/41). 3/5/41 granted.
- Mar. 26—Motion for extension to April 4, 1941, to file reply brief filed by taxpayer. 3/26/41 granted.
- Mar. 31—Reply brief filed by taxpayer. (Index to original briefs also received.) 3/31/41 copy served on General Counsel.
- Aug. 13—Findings of fact and opinion rendered. Sternhagen, #10. Decision will be entered under Rule 50. 8/14/41 copy served.
- Sept. 9—Computation of deficiency filed by General Counsel.
- Sept. 11—Hearing set Oct. 1, 1941, on settlement.
- Oct. 1—Hearing had before Mr. Arundell on Rule 50. Not contested. Referred to Sternhagen for decision.
- Oct. 2—Decision entered. Sternhagen, Division 10.
- Dec. 26—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, filed by taxpayer, with affidavit of mailing.

1942

- Feb. 6—Certified copy of order and affidavit from the U. S. Circuit Court of Appeals, 9th Circuit, extending the time 30 days from Feb. 4, 1942, within which to file the certified record filed.
- Feb. 12—Stipulation to omit certain portions of the reporter's transcript filed.

1942

Feb. 27—Praecipe for record filed by taxpayer, with proof of service thereon.

Mar. 4—Certified copy of order from the 9th Circuit re consolidation and preparing single record filed.

Mar. 4—Certified copy of order from the 9th Circuit extending the time fifteen additional days from March 6, 1942, within which to file the certified record filed. [4]

United States Board of Tax Appeals

Docket No. 101189

W. R. WHITTHORNE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above named Petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols IRA:90-D/LB), dated October 20, 1939, and as a basis of his proceeding alleges as follows:

I.

Petitioner is an individual with residence in the City of Oakland, County of Alameda, State of California.

II.

That a notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was mailed to Petitioner on October 20, 1939.

III.

The taxes in controversy are income taxes for the calendar year 1936 in the amount of \$9,902.53 and penalty in the amount of \$495.12. [5]

IV.

The determination of the tax set forth in the said notice of deficiency is based upon the following errors and each thereof:

(a) The Commissioner erred in finding that Petitioner received any benefit whatsoever in the calendar year 1936 by the cancellation during said calendar year of the indebtedness owing by him to Bank of America National Trust and Savings Association and Central National Bank of Oakland in the aggregate sum of \$80,009.13 and the respective sums of \$24,968.47 and \$55,040.66, since the benefit arose from a transaction which took place in the calendar year 1930.

(b) Even if the benefit from the cancellation of said indebtedness is applicable to the year 1936 and not the year 1930, the Commissioner nevertheless erred in holding and determining that the benefit to Petitioner from said cancellation of indebtedness, or any part thereof, constituted taxable income to Petitioner as, under the circumstances hereinafter alleged, said cancellation of indebtedness is not in-

come within the meaning of the Revenue Act of 1936 or the Sixteenth Amendment to the Constitution.

(c) The Commissioner erred in finding that, during the calendar year 1936, Petitioner realized a reportable [6] capital gain on the sale of a one-half interest in 1,000 shares of Sherwood Swan and Company, Ltd. in the amount of \$19,895.25. However, Petitioner sold during said calendar year 1936, 6,250 Class A shares of Sherwood Swan and Company, Ltd. for an aggregate selling price of \$43,750. The cost allocable to said 6,250 Class A shares was \$14,771.17 and Taxpayer realized a gain of \$28,978.83 on said sale of Class A shares, and a reportable gain of \$8,693.65.

(d) The Commissioner erred in assessing against Petitioner a 5% penalty under Section 291 of the Revenue Act of 1936 on account of the alleged delinquent filing by Petitioner of his return for said calendar year. [7]

V.

The facts upon which the Petitioner relies as the basis of this proceeding are as follows:

In support of assignment of error (a) above:

1. In March 1930, Petitioner's assets consisted solely of:

(i) An account receivable due from Sherwood Swan and Company, Ltd. in the amount of \$5,567.34;

(ii) 500 Shares of Sherwood Swan and Company, Ltd.;

(iii) 6,000 shares of Hale Bros. Stores, Inc.;

(iv) 1,725 shares of Wasserman-Gattman Co.; and

(v) 2,000 shares of Swan's (a corporation); and

the liabilities of Petitioner consisted of:

((i)) Joint note of Petitioner and Sherwood Swan to Harrison S. Robinson in the principal amount of \$35,000, secured by pledge of 1,000 shares of Sherwood Swan and Company, Ltd. (held by Petitioner and Sherwood Swan, jointly);

((ii)) Joint unsecured note of Petitioner and Sherwood Swan to Bank of America National Trust and Savings Association in the principal amount of \$100,000;

((iii)) Joint notes of Petitioner and Sherwood Swan to Central National Bank of Oakland in the aggregate principal amount of \$250,000, secured by 6,000 shares of Hale Bros. Stores, Inc., held by Petitioner; and

((iv)) Joint purchase money note of Petitioner and Sherwood Swan to David S. Wasserman in the principal amount of \$100,000, secured by 1,000 shares of Wasserman-Gattmann Co., 500 of which shares were held by Petitioner and 500 of which shares were held by said Sherwood Swan.

2. On or about March 12, 1930 Petitioner and Sherwood Swan entered into an agreement with

Bank of America National Trust and Savings Association and the Central National Bank of Oakland, under which Petitioner and Sherwood Swan pledged to each of said [8] banks as security for their obligations to such banks, referred to in paragraph 1 above, 1,225 shares of said Wasserman-Gattmann Co. and 2,000 shares of Swan's (a corporation), held by Petitioner and Sherwood Swan jointly, and Petitioner and Sherwood Swan also pledged with each of said banks 500 shares of Sherwood Swan and Company, Ltd. held by Petitioner and Sherwood Swan jointly; subject, however, to said pledge thereof to Harrison S. Robinson to secure the payment of said note in the amount of \$35,000, and under which each of said banks absolutely and unconditionally agreed that it would look to said 500 shares of Sherwood Swan and Company, Ltd. so pledged with it for the payment of only \$100,000 amount of the indebtedness owing to it by Petitioner and said Sherwood Swan, or either of them, and amounts advanced by the bank to pay said note to Harrison S. Robinson, and that upon the payment of said sum of \$100,000 on account of said indebtedness and the payment of any amounts advanced by said bank to pay said note of Harrison S. Robinson, said 500 shares of Sherwood Swan and Company, Ltd. would be free from pursuit on account of any and all indebtedness owing to it by Petitioner and Sherwood Swan, or either of them.

3. Each of said banks paid one-half of said indebtedness owing to Harrison S. Robinson and prior

to December 16, 1936 Petitioner and Sherwood Swan paid to each of said banks the amount advanced by it to pay said indebtedness to Harrison S. Robinson and paid \$10,933.67 on account of the principal of said \$100,000 of said indebtedness owing to it by Petitioner [9] and Sherwood Swan. That in connection with the cancellation and settlement of indebtedness on December 16, 1936, referred to in the notice of deficiency attached hereto as Exhibit A, Petitioner and Sherwood Swan paid to each of said banks the remaining balance of said \$100,000. That consequently the release of said 500 shares was within the contemplation of said agreement of March 12, 1930.

4. That after said cancellation and settlement of indebtedness on December 16, 1936, Petitioner had no assets other than said 500 shares of said Sherwood Swan and Company, Ltd., and the liabilities of Petitioner (other than the liabilities in the aggregate amount of \$195,000 incurred in connection with the payment of said indebtedness to said banks) consisted of joint accounts payable by Petitioner and Sherwood Swan to Anglo California National Bank in the amount of \$5,000 and to Orrick, Palmer & Dahlquist in the amount of \$2,000.

5. That consequently no assets of Petitioner were released from the burden of said indebtedness to Bank of America National Trust and Savings Association and Central National Bank of Oakland by operation of said cancellation and settlement of indebtedness on December 16, 1936 which had not

already been released by said agreement of March 12, 1930. That in view of the foregoing, Petitioner did not derive any benefit whatsoever by reason or by virtue of the cancellation and settlement of indebtedness on December 16, 1936. [10]

In support of assignment of error (b) above:

6. That the cost to Petitioner of said 500 shares of Sherwood Swan and Company, Ltd. was \$50,000; that at the time of the cancellation and settlement of said indebtedness on December 16, 1936, the fair market value of said shares was considerably in excess of \$50,000; that under the provisions of the Revenue Act of 1936, upon the sale of said 500 shares of Sherwood Swan and Company, Ltd. (including shares received by Petitioner in exchange therefor in connection with the tax-free reorganization of said Sherwood Swan and Company, Ltd. hereinafter referred to) Petitioner would realize a taxable gain computed on the basis of said cost of \$50,000; that if Petitioner were required to take into account in computing net income for the calendar year 1936 the amount of any benefit derived from said cancellation and settlement of indebtedness on December 16, 1936 computed (among other things) on the basis of said fair market value of said 500 shares of Sherwood Swan and Company, Ltd.

(i) Petitioner would in fact be subject to two income taxes on the same income and value, i. e., a tax on the increase in value of said 500 shares of Sherwood Swan and Company, Ltd.

over their cost on account of said benefit derived from said cancellation and settlement of indebtedness and a tax on such increase on the sale of said shares; and

(ii) Petitioner would be taxed on an unrealized gain arising in connection with the increase in value of said 500 shares of Sherwood Swan and Company, Ltd. over the cost thereof not representing taxable income and not subject to taxation under the Revenue Act of 1936 or the Sixteenth Amendment to the Constitution of the United States. [11]

That no benefit would result to Taxpayer on account of said cancellation and settlement of indebtedness on December 16, 1936 if, for the purpose of computing the same, there is assigned to said 500 shares of Sherwood Swan and Company, Ltd. a value equal to said cost thereof in the amount of \$50,000.

In support of assignment of error (c) above:

7. That during the calendar year 1936 Petitioner did not sell or enter into any contract to sell any shares of Sherwood Swan and Company, Ltd., except as is hereinafter more particularly set forth in this paragraph 7. That prior to December 21, 1936 Petitioner held 500 shares of Sherwood Swan and Company, Ltd. and that the cost of said shares to Petitioner was \$50,000. That on December 21, 1936, in connection with the tax-free reorganization of Sherwood Swan and Company, Ltd. Petitioner exchanged said 500 shares of Sher-

wood Swan and Company, Ltd. for 15,000 Class A shares and 22,500 common shares of Sherwood Swan and Company, Ltd. That at the time of said exchange the fair market value of said 15,000 Class A shares was \$105,000 and the fair market value of said 22,500 common shares was not in excess of \$43,092.50. That the portion of said cost of \$50,000 allocable to said 15,000 Class A shares was not less than \$35,450.81. That on November 18, 1936, Petitioner entered into a contract with Albert Gersten and Robert E. Hill, doing business under the firm name and style of "Robert N. Miller & Co." for the sale [12] to said purchasers of 12,500 Class A shares of Sherwood Swan and Company, Ltd. at a price of \$7 per share and a total price of \$87,500. That said purchasers, pursuant to said contract, during the calendar year 1936 purchased from Petitioner 6,250 of said Class A shares and paid therefor to Petitioner a total of \$43,750, and during the calendar year 1937 purchased 6,250 of said Class A shares and paid therefor to Petitioner a total of \$43,750. That consequently, during the calendar year 1936, Petitioner sold only 6,250 of said Class A shares for said total purchase price of \$43,750. That the cost allocable to said 6,250 Class A shares was not in excess of \$14,771.17 and that the gain derived from the sale thereof by Petitioner was not in excess of \$28,978.83.

In support of assignment of error (d) above:

Petitioner obtained extensions to June 1, 1937, to file his return for the calendar year 1936. Petitioner verily believes that said return was filed by

him on June 1, 1937. That said return was prepared for Petitioner by his accountants, Messrs. Barrow, Wade, Guthrie & Co., Certified Public Accountants. That by reason of the complexity of the matters covered by said return, a considerable amount of time was required to prepare it. That as soon as said return had been prepared Petitioner signed and verified it and filed it with the Collector of Internal Revenue. [13]

Wherefore, Petitioner prays that this Board may hear the proceeding and determine that there was a deficiency of \$177.65 and no penalty due from Petitioner for the year 1936.

HILLYER BROWN

CHAS. L. BARNARD

Counsel for Petitioner. [14]

State of California,
City and County of San Francisco—ss.

W. R. Whitthorne, being duly sworn, says that he is the Petitioner above named; that he has read the foregoing Petition, and is familiar with the statements contained therein, and that the facts stated are true.

W. R. WHITTHORNE

Subscribed and sworn to before me this 12th day of January, 1940.

[Seal]

ANNE F. SWIFT,

Notary Public in and for the City and County of
San Francisco, State of California. [15]

EXHIBIT A

Letterhead of
Treasury Department
Internal Revenue Service
San Francisco, Calif.

Oct. 20, 1939

IRA:90-D

LB

Mr. W. R. Whitthorne,
324 Pacific Avenue,
Oakland, California

Sir:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1936, and December 31, 1937, discloses a deficiency of \$9,952.27 and \$495.12 in penalty, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Room 433, Federal Office Building, Civic Center, San

Francisco, California, for the attention of Conference Section. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,

Commissioner,

(Signed) By F. M. HARLESS

Internal Revenue Agent in
Charge.

H.J.B. (Signed)

Enclosures:

Statement

Form of Waiver [16]

Statement

San Francisco

IRA:90-D

LB

Mr. W. R. Whitthorne,

324 Pacific Avenue,

Oakland, California.

Tax Liability for the Taxable Years Ended December 31, 1936 and December 31, 1937.

	Liability	Assessed	Deficiency
Income Tax 1936.....	\$9,902.53	None	\$9,902.53
1937.....	958.46	\$908.72	49.74
Penalty 1936.....	\$ 495.12	None	\$ 495.12

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated January 6, 1939, to your protest dated April 14, 1939 and to the statements made at the conference held on May 16, 1939.

Your income tax return for the year 1936 was filed on June 2, 1937, whereas an extension granted to you by the Collector of Internal Revenue expired on June 1, 1937. Inasmuch as your income tax return was not filed within the time prescribed by law, or prescribed by the Commissioner in pursuance of law, five per centum of the tax has been added thereto in accordance with the provisions of Section 291, Revenue Act of 1936. [17]

ADJUSTMENTS TO NET INCOME

Year: 1936

Net income as disclosed by return.....	\$1,280.60
Unallowable deductions and additional income	
(a) Forgiveness of indebtedness.....	\$35,040.66
(b) Capital gain increased.....	21,895.25
Total	\$56,935.91
	<hr/>
	\$58,216.51
Nontaxable income and additional deductions	
(c) Interest paid	\$ 5,103.59
	5,103.59
	<hr/>
Net income adjusted.....	\$53,112.92

Explanation of Adjustments

(a) On December 16, 1936, there was effected a settlement of the loan liabilities of yourself and Mr. Sherwood Swan to the Central National Bank of Oakland and the Bank of America N. T. & S. A., whereby principal indebtedness aggregating \$339,-147.65 was cancelled in consideration of the payment of \$175,000.00 cash and the transfer of certain stocks pledged as collateral on the loans.

Reportable profits on this transaction have been computed as follows: [18]

Creditor	Total loan Liabilities	Sherwood Swan	W. R. Whitthorne
Bank of America N.T. & S.A.....	\$65,000.00	\$65,000.00	
Bank of America.....	89,066.33	44,533.16	\$44,533.17
Total	<u>\$154,066.33</u>	<u>\$109,533.16</u>	<u>\$44,533.17</u>
Payments			
Cash	\$100,000.00	\$ 50,000.00	\$50,000.00
2071 shares Hale Brothers Realty...	34,564.69	34,564.69	—
1225 shares Wasserman-Gattman.....	No value	—	—
2000 shares Swan's.....	No value	—	—
Total	<u>\$134,564.69</u>	<u>\$84,564.69</u>	<u>\$50,000.00</u>
Profit realized (loss).....	\$ 19,501.64	\$24,968.47	\$(5,466.83)

There is omitted from this calculation accrued but unpaid interest for the current year and prior years of \$35,773.47 and a loan liability of the Wasserman-Gattman Company of \$6,233.34 for which Swan and Whitthorne had only a contingent liability.

Creditor	Total loan Liabilities	Sherwood Swan	W. R. Whitthorne
Central National Bank of Oakland...	\$165,081.32	\$82,540.66	\$82,540.66
Central National Bank of Oakland...	20,000.00	20,000.00	—
Total	\$185,081.32	\$102,540.66	\$82,540.66
Payments			
Cash	\$ 75,000.00	\$ 37,500.00	\$37,500.00
New note of Swan and Whitthorne	20,000.00	10,000.00	10,000.00
Total	\$ 95,000.00	\$ 47,500.00	\$47,500.00
Profit realized	\$ 90,081.32	\$ 55,040.66	\$35,040.66
Total profit (loss) through both transactions	\$109,582.96	\$ 80,009.13	\$35,040.66 \$(5,466.83)

(There is omitted from this calculation, accrued but unpaid interest for the current and prior years of \$27,033.72).

[19]

In effecting the settlement, the Central National Bank of Oakland released 500 shares of Sherwood Swan and Company, Ltd., and the Bank of America also released 500 shares of Sherwood Swan and Company, Ltd., which had been deposited by the joint debtors. However, the Bank of America withheld and assumed title to 1225 shares of Wasserman-Gattman Company, 2,000 shares Swan's and 2071 shares of Hale Brothers Realty Company. To effect this transfer a pledgee's sale was held and the creditor ostensibly bought in these stocks for \$96,073.14, which represented the unpaid balance of the Bank of America loans plus accrued interest. However, at this time, stocks in the Wasserman-Gattman Company, and Swan's, Inc. were entirely worthless, while the market value of the 2071 shares

of Hale Brothers Realty Company stock was \$34,564.69. Since the transaction was negotiated and agreed to on the basis of a cancellation of the unpaid note balances, over and above the value of the stocks surrendered, the pledge sale at the artificial figure of \$96,073.14 is disregarded; credit is given for a payment by Sherwood Swan and yourself equivalent to \$34,564.69, the market value of 2071 shares of Hale Brothers Realty Company stock. The unpaid balance of \$19,501.64, represents a cancellation of \$24,968.47 in favor of Sherwood Swan offset by a payment of \$5,466.83 by you in excess of principal due from you but applying on unpaid interest due from you.

The benefit from cancellation of your indebtedness in the amount of \$35,040.66 as shown, is held to be taxable income in accordance with Article 22(a)-14 of Treasury Regulations 94 and *Walker v. Comm.* 88 Fed. (2) 170.

(b) Your reportable capital gain is revised as follows:

	Per return	Revised
Profit on one-half interest in 1,000 shares Sherwood, Swan and Company Ltd.	\$19,895.25	\$19,895.25
Loss, one-half interest in 1,225 shares Wasserman-Gattman Company	(30,549.91)	None
Loss, one-half interest in 2,000 shares Swan's, Inc.	(9,969.35)	None
Net	\$(20,624.01)	\$19,895.25
Add: Limited deduction claimed on return.....		2,000.00
Total increase in reportable income.....		<u>\$21,895.25</u>

Although the stocks in Wasserman, Gattman Company, and Swan's, Inc. were transferred to the Bank of America N. T. S. A. in connection with the debt settlement, such stocks had no value at the time. No loss on the transfer is allowable for the reason that such stocks were determined worthless prior to the taxable year. The holding that such stocks were worthless is based on the fact that in his 1933 return, Sherwood Swan claimed a deduction due to worthlessness of stock in the Wasserman-Gattman Company, which was disallowed by the Commissioner on the ground that this stock became worthless in the year 1930. Since the only asset of Swan's, Inc. was holdings of stock in the Wasserman-Gattman Company, it, too, is held to have become worthless in 1930.

(c) Since the debt settlement with the Bank of America N. T. S. A. you paid \$5,466.83 more than the amount of your principal liability, such excess is considered as a partial payment of the accrued interest and a deduction therefor allowed. Offsetting such allowance, the interest deduction of \$363.24 claimed on your return as paid in connection with this settlement is eliminated, leaving a net additional allowance of \$5,103.59. [21]

COMPUTATION OF TAX

Year: 1936

Net income adjusted.....	\$53,112.92
Less:	
Personal exemption	\$2,500.00 2,500.00
	<hr/>
Balance (surtax net income).....	\$50,612.92
Less:	
Earned income credit.....	300.00
	<hr/>
Net income subject to normal tax.....	\$50,312.92
Normal tax at 4% on \$50,312.92.....	\$ 2,012.52
Surtax on \$50,612.92.....	7,890.01
	<hr/>
Correct income tax liability.....	\$ 9,902.53
Income tax assessed:	
Original, First California, Account No. 684,430	None
Deficiency of income tax.....	\$ 9,902.53
Penalty of 5%, Section 291 Revenue Act of 1936	\$ 495.12
Penalty assessed	None
	<hr/>
Deficiency	\$ 495.12

ADJUSTMENTS TO NET INCOME

Year: 1937

Net income as disclosed by return.....	\$14,506.02
Unallowable deductions and additional income	
(a) Capital gain increased.....	\$414.46 414.46
	<hr/>
Net income adjusted.....	\$14,920.48

[22]

Explanation of Adjustments

(a) In 1937, you transferred to Sherwood Swan 4,500 shares of Sherwood Swan & Co. Ltd., common stock in exchange for his assumption of your note liabilities. Capital gain from this transaction is computed as follows:

Your liability on joint non-interest bearing note of \$20,000.00 executed 12/16/1936.....	\$10,000.00
Your liability on joint interest bearing note of \$10,000.00	5,000.00
Total proceeds to you.....	\$15,000.00
Cost: 4500 shares Sherwood Swan & Co. Ltd., com- mon stock at \$1.0924 per share.....	4,915.80
Profit realized	\$10,084.20
Reportable under provisions of Section 117, Reve- nue Act of 1936, since stock held over ten years, 30%	\$ 3,025.26
Gain reported in return.....	2,610.80
Increase	\$ 414.46
	[23]

COMPUTATION OF TAX

Year: 1937

Net income adjusted.....	\$14,920.48
Less:	
Personal exemption	\$2,500.00 2,500.00
Balance (surtax net income).....	\$12,420.48
Less:	
Earned income credit.....	300.00
Net income subject to normal tax.....	\$12,120.48
Normal tax at 4% on \$12,120.48.....	\$ 484.82
Surtax on \$12,420.48.....	473.64
Correct income tax liability.....	\$ 958.46
Income tax assessed:	
Original, First California, Account No. 200,111, May 1938.....	908.72
Deficiency of income tax.....	\$ 49.74

[Endorsed]: Filed Jan. 16, 1940. [24]

[Title of Board and Cause—Docket No. 101189.]

FIRST AMENDMENT TO PETITION

The petition of W. R. Whitthorne filed in the above entitled matter for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols IRA:90-D/LB), dated October 20, 1939, is amended as follows:

1.

Paragraph III of said petition is amended to read:

“The taxes in controversy are income taxes for the calendar year 1936 in the amount of \$9,724.88 and penalty in the amount of \$495.12.”

2.

Subparagraph (a) of paragraph IV of said petition is amended to read:

“(a) The Commissioner erred in finding that Petitioner received any benefit whatsoever in the calendar year 1936 by the cancellation during said calendar year of the [25] indebtedness owing by him to Central National Bank of Oakland in the sum of \$35,040.66, since the benefit arose from a transaction which took place in the calendar year 1930.”

Dated: January 17, 1940.

HILLYER BROWN

CHAS. L. BARNARD

Counsel for Petitioner. [26]

State of California,
County of Alameda—ss.

W. R. Whitthorne, being duly sworn, says that he is the Petitioner above named; that he has read the foregoing First Amendment to Petition, and is familiar with the statements contained therein, and that the facts stated are true.

W. R. WHITTHORNE.

Subscribed and sworn to before me this 17th day of January, 1940.

(Seal) BESSIE E. COTTON,
Notary Public in and for the County of Alameda,
State of California.

[Endorsed]: Filed Jan. 19, 1940. [27]

[Title of Board and Cause—Docket No. 101189.]

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition, as amended, filed by the above-named petitioner admits and denies as follows:

I. Admits the allegations contained in paragraph I of the petition as amended.

II. Admits the allegations contained in paragraph II of the petition as amended.

III. Admits that the tax in controversy is income tax for the calendar year 1936; denies the re-

maining allegations contained in paragraph III of the petition as amended.

IV(a) to (d), incl. Denies that the Commissioner erred as alleged in subparagraphs (a) to (d), inclusive, of paragraph IV of the petition as amended. [28]

V-1. For lack of materiality, denies all allegations contained in subparagraph 1 of paragraph V of the petition as amended.

V-2. For lack of materiality, denies all allegations contained in subparagraph 2 of paragraph V of the petition as amended.

V-3. Admits that on December 16, 1936, there was a cancellation and settlement of the indebtedness referred to in the notice of deficiency attached to the petition as Exhibit A; denies the remaining allegations contained in subparagraph 3 of paragraph V of the petition as amended.

V-4 and V-5. Denies all allegations contained in subparagraphs 4 and 5 of paragraph V of the petition as amended.

V-6. Admits that the cost to petitioner of 500 shares of Sherwood Swan and Company, Ltd., stock was \$50,000; that at the time of the cancellation and settlement of said indebtedness on December 16, 1936, the fair market value of said shares was considerably in excess of \$50,000; denies the remaining allegations contained in subparagraph 6 of paragraph V of the petition as amended.

V-7. Admits that prior to December 21, 1936, petitioner held 500 shares of Sherwood Swan and

Company, Ltd., stock; that the cost of said shares to petitioner was \$50,000; that on December 21, 1936, in connection with the tax-free reorganization of Sherwood Swan and Company, Ltd., petitioner exchanged said 500 shares of [29] Sherwood Swan and Company, Ltd., stock for 15,000 Class A shares and 22,500 common shares of Sherwood Swan and Company, Ltd., stock; that on November 18, 1936, petitioner entered into a certain contract with Albert Gersten and Robert E. Hill, doing business under the firm name and style of "Robert N. Miller & Co.," for the sale to said purchasers of certain Class A shares of Sherwood Swan and Company, Ltd., at a price of \$7 per share, denies the remaining allegations contained in subparagraph 7 of paragraph V of the petition as amended.

VI. Admits that petitioner obtained extensions until June 1, 1937, to file his income tax return for the calendar year 1936; denies the remaining allegations set forth in the petition as amended under the heading "In support of assignment of error (d) above."

VII. Denies generally and specifically each and every allegation in the petition as amended not herebefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's

determination be approved and petitioner's appeal denied.

J. P. WENCHEL,
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

ALVA C. BAIRD,
T. M. MATHER,
HARRY R. HORROW,
Special Attorneys,
Bureau of Internal Revenue.

[Endorsed]: Filed Feb. 15, 1940. [30]

[Title of Board and Cause—Docket No. 101189.]

SECOND AMENDMENT TO PETITION

The petiton of W. R. Whitthorne filed in the above entitled matter for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols IRA:90-D/LB, dated October 20, 1939, is amended as follows by Minnie L. Whitthorne and Eva Whitthorne, Executrices of the Estate of W. R. Whitthorne, the original petitioner herein:

I.

Paragraph III of said Petition is amended to read:

“The taxes in controversy are income taxes for the calendar year 1936 in the amount of \$9,812.45 and penalty in the amount of \$495.12.”

II.

Paragraph IV of said Petition is amended by inserting at the end of subparagraph (b) thereof a new subparagraph numbered (b-1) to read as follows: [31]

“(b-1) Even if the benefit from the cancellation of said indebtedness is applicable to the year 1936 and not the year 1930, and even if cancellation of indebtedness under the circumstances hereinafter alleged constituted taxable income, said income could not have exceeded the sum of \$4,000.00 and consequently the Commissioner erred in finding that the income to Petitioner from said cancellation was in the amount of \$35,040.66.”

III.

Paragraph IV(c) of said Petition is amended to read:

“(c) The Commissioner erred in finding that during the calendar year 1936 Petitioner sold a one-half interest in 1,000 shares of Sherwood Swan and Company, Ltd., and in finding that the cost or other basis of said 1,000 shares was \$42,365 and in finding that said 1,000 shares were sold for an aggregate sum of \$175,000, or any other sum whatsoever, and in finding that Petitioner's share of the profit from such sale was \$66,317.50, or any other sum whatsoever. However, Petitioner sold, during said calendar year 1936, 6,250 Class A shares of Sherwood

Swan and Company, Ltd., for an aggregate selling price of \$43,750. The cost allocable to said 6,250 Class A shares was \$20,833.33 and Taxpayer realized a gain of \$22,916.67 on said sale of Class A shares.”

IV.

Subparagraph 1.(i) of paragraph V of said Petition is amended to read:

“(i) An account receivable due from Sherwood Swan and Company, Ltd., in the amount of \$5,506.09;”

V.

Paragraph V is amended by inserting at the end of subparagraph 6 thereof a new subparagraph numbered 6(a) to read as follows: [32]

“In support of assignment of error (b-1) above:

“6(a) That immediately after the cancellation and settlement of indebtedness on December 16, 1936, referred to in said notice of deficiency, a copy of which is attached hereto and marked ‘Exhibit A,’ Petitioner’s assets consisted of:

500 shares of Sherwood Swan and Company Ltd., having a fair market value of not in excess of \$105,000 and the liabilities of Petitioner consisted of:

(i) Joint note of Petitioner and Sherwood Swan to The Anglo California National Bank in the principal amount of \$175,000;

(ii) Joint note of Petitioner and Sherwood Swan to the Central Company in the principal amount of \$20,000;

(iii) Joint account payable by Petitioner and said Sherwood Swan to Orrick, Palmer & Dahlquist in the amount of \$2,000; and

(iv) Joint obligation of Petitioner and said Sherwood Swan to Anglo California National Bank in the amount of \$5,000.

That the aggregate value of said assets of Petitioner was \$105,000 and that the aggregate amount of Petitioner's said liabilities (including, in the case of joint obligations, only Petitioner's one-half thereof) was \$101,000 and that the amount by which the value of Petitioner's said assets exceeded the amount of his said liabilities was \$4,000.

That by reason of the foregoing, if Petitioner derived any benefit from said cancellation and settlement of indebtedness on December 16, 1936, such benefit was not in excess of \$4,000." [33]

VI.

Subparagraph 7 of paragraph V of said Petition is amended to read:

"In support of assignment of error (c) above:

"7. That during the calendar year 1936 Petitioner did not sell or enter into any contract to sell any shares of Sherwood Swan and Company, Ltd., except as is hereinafter more particularly set forth in this paragraph 7. That

prior to December 21, 1936, Petitioner held 500 shares of Sherwood Swan and Company, Ltd., and that the cost of said shares to Petitioner was \$50,000. That on December 21, 1936, in connection with the tax-free reorganization of Sherwood Swan and Company, Ltd., Petitioner exchanged said 500 shares of Sherwood Swan and Company, Ltd., for 15,000 Class A shares and 22,500 common shares of Sherwood Swan and Company, Ltd. That at the time of said exchange the fair market value of said 15,000 Class A shares was \$105,000 and the said 22,500 common shares had no fair market value. That all of said cost of \$50,000 was allocable to said 15,000 Class A shares. That on November 18, 1936, Petitioner entered into a contract with Albert Gersten and Robert E. Hill, doing business under the firm name and style of 'Robert N. Miller & Co.' for the sale to said purchasers of 12,500 Class A shares of Sherwood Swan and Company, Ltd., at a price of \$7 per share and a total price of \$87,500. That said purchasers, pursuant to said contract, during the calendar year [34] 1936 purchased from Petitioner 6,250 of said Class A shares and paid therefor to Petitioner a total of \$43,750, and during the calendar year 1937 purchased 6,250 of said Class A shares and paid therefor to Petitioner a total of \$43,750. That consequently, during the calendar year 1936, Petitioner sold only 6,250 of said Class A shares for said total purchase price of \$43,750. That the cost allocable to said

6,250 Class A shares was not in excess of \$20,833.33 and that the gain derived from the sale thereof by Petitioner was not in excess of \$22,916.67.”

VII.

The prayer of said Petition is amended to read:

“Wherefore, Petitioner prays that this Board may hear the proceeding and determine that there is a deficiency of \$90.08 and no penalty due from Petitioner for the year 1936.

ROBERT W. MACDONALD,

Counsel for Petitioner.

1600 Financial Center Bldg.
Oakland, California. [35]

State of California,
County of Alameda—ss.

Eva Whitthorne, being duly sworn, deposes and says: That she is one of the Executrices of the Estate of the Petitioner above named; that she has read the foregoing Second Amendment to Petition, and is familiar with the statements contained therein, and that the facts stated are true.

EVA WHITTHORNE.

Subscribed and sworn to before me this 17th day of October, 1940.

(Seal)

A. McCREADY,

Notary Public in and for the County of Alameda,
State of California.

[Endorsed]: Filed Oct. 21, 1940 [36]

[Title of Board and Cause—Docket No. 101189.]

ORDER

On suggestion of death of the petitioner and notice of the appointment of Executrices filed in the above-entitled proceeding, it is

Ordered: That Minnie L. Whitthorne and Eva Whitthorne, Executrices of the Estate of W. R. Whitthorne, deceased, be and they hereby are substituted in the place and stead of W. R. Whitthorne, deceased, and that henceforth the title of this proceeding shall be Estate of W. R. Whitthorne, deceased, Minnie L. Whitthorne and Eva Whitthorne, Executrices, Petitioners, v. Commissioner of Internal Revenue, Respondent.

(Signed) J. M. STERNHAGEN
Member.

Dated: San Francisco, Calif., October 21, 1940.

[37]

[Title of Board and Cause—Docket No. 101189.]

ANSWER TO SECOND AMENDMENT TO
PETITION

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the Second Amendment to Petition filed by the above-named petitioner, admits and denies as follows:

I.

Admits the allegations contained in paragraph I of the Second Amendment to Petition, except as to the amount of income taxes in controversy, which is denied.

II.

Denies the allegations contained in paragraph II of the Second Amendment to Petition. [38]

III.

Denies the allegations contained in paragraph III of the Second Amendment to Petition.

IV.

Denies the allegations contained in paragraph IV of the Second Amendment to Petition.

V.

Denies the allegations contained in paragraph V of the Second Amendment to Petition.

VI.

Denies the allegations contained in paragraph VI of the Second Amendment to Petition.

VII.

Denies generally and specifically each and every allegation in the Second Amendment to the Petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's

determination be approved and that the petitioner's appeal be denied.

J. P. WENCHEL,

Chief Counsel,

Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD,

Division Counsel.

T. M. MATHER,

Special Attorney,

Bureau of Internal Revenue.

[Endorsed]: Filed Oct. 31, 1940 [39]

United States Board of Tax Appeals

Docket No. 101190

SHERWOOD SWAN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

The above named Petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols IRA:90-D/LB), dated October 20, 1939, and as a basis of his proceeding alleges as follows:

I.

Petitioner is an individual with residence in the City of Oakland, County of Alameda, State of California.

II.

That a notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was mailed to Petitioner on October 20, 1939.

III.

The taxes in controversy are income taxes for the calendar year 1936 in the amount of \$44,854.91 and penalty in the amount of \$2,242.74. [40]

IV.

The determination of the tax set forth in the said notice of deficiency is based upon the following errors and each thereof:

(a) The Commissioner erred in finding that Petitioner received any benefit whatsoever in the calendar year 1936 by the cancellation during said calendar year of the indebtedness owing by him to Bank of America National Trust and Savings Association and Central National Bank of Oakland in the aggregate sum of \$80,009.13 and the respective sums of \$24,968.47 and \$55,040.66, since the benefit arose from a transaction which took place in the calendar year 1930.

(b) Even if the benefit from the cancellation of said indebtedness is applicable to the year 1936 and not the year 1930, the Commissioner nevertheless

erred in holding and determining that the benefit to Petitioner from said cancellation of indebtedness, or any part thereof, constituted taxable income to Petitioner as, under the circumstances hereinafter alleged, said cancellation of indebtedness is not income within the meaning of the Revenue Act of 1936 or the Sixteenth Amendment to the Constitution.

(c) Even if the benefit from the cancellation of said indebtedness is applicable to the year 1936 and not the year 1930, and even if cancellation of indebtedness under the circumstances hereinafter alleged constituted taxable income, said income could not have exceeded the sum of \$24,270.14 [41] and consequently the Commissioner erred in finding that the income to Petitioner from said cancellation was in the amount of \$80,009.13.

(d) The Commissioner erred in finding that during the calendar year 1936 Petitioner sold a one-half interest in 1,000 shares of Sherwood Swan and Company, Ltd. and is finding that the cost or other basis of said 1,000 shares was \$42,365 and in finding that said 1,000 shares were sold for an aggregate sum of \$175,000, or any other sum whatsoever, and in finding that Petitioner's share of the profit from such sale was \$66,317.50, or any other sum whatsoever. However, Petitioner sold, during said calendar year 1936, 6,250 Class A shares of Sherwood Swan and Company, Ltd. for an aggregate selling price of \$43,750. The cost allocable to said 6,250 Class A shares was \$14,771.17 and Taxpayer

realized a gain of \$28,978.83 on said sale of Class A shares.

(e) The Commissioner erred in assessing against Petitioner a 5% penalty under Section 291 of the Revenue Act of 1936 on account of the alleged delinquent filing by Petitioner of his return for said calendar year. [42]

V.

The facts upon which the Petitioner relies as the basis of this proceeding are as follows:

In Support of assignment of error (a) above:

1. In March 1930, Petitioner's assets consisted solely of:

(i) An account receivable due from Wasserman-Gattmann Co. in the amount of \$2,425.55;

(ii) 500 shares of Sherwood Swan and Company, Ltd.;

(iii) 2,071 shares of Hale Bros. Realty Co.;

(iv) 1,725 shares of Wasserman-Gattman Co.;

(v) 2,000 shares of Swan's (a corporation); and

(vi) a ranch situated in Madera County, California;

and the liabilities of Petitioner consisted of:

((i)) Joint note of Petitioner and W. R. Whitthorne to Harrison S. Robinson in the principal amount of \$35,000, secured by pledge of 1,000 shares of Sherwood Swan and Com-

pany, Ltd. (held by Petitioner and W. R. Whitthorne, jointly);

((ii)) Joint unsecured note of Petitioner and W. R. Whitthorne to Bank of America National Trust and Savings Association in the principal amount of \$100,000;

((iii)) Joint notes of Petitioner and W. R. Whitthorne to Central National Bank of Oakland in the aggregate principal amount of \$250,000, secured by 6,000 shares of Hale Bros. Stores, Inc., held by W. R. Whitthorne;

((iv)) Note of Petitioner to Bank of America National Trust and Savings Association in the principal amount of \$65,000, secured by said 2,071 shares of Hale Bros. Realty Co.;

((v)) Note of Petitioner to Central National Bank of Oakland in the amount of \$20,000;

((vi)) Note of Petitioner to Bank of America National Trust and Savings Association having a remaining [43] principal balance of \$10,000 secured by a mortgage on said ranch in Madera County; and

((vii)) Joint purchase money note of Petitioner and W. R. Whitthorne to David S. Wasserman in the principal amount of \$100,000, secured by 1,000 shares of Wasserman-Gattmann Co., 500 of which shares were held by Petitioner and 500 of which shares were held by said W. R. Whitthorne.

2. On or about March 12, 1930 Petitioner and W. R. Whitthorne entered into an agreement with Bank of America National Trust and Savings Association and the Central National Bank of Oakland, under which Petitioner and W. R. Whitthorne pledged to each of said banks, as security for their obligations to such banks, referred to in paragraph 1 above, 1,225 shares of said Wasserman-Gattmann Co. and 2,000 shares of Swan's (a corporation), held by Petitioner and W. R. Whitthorne jointly, and Petitioner and W. R. Whitthorne also pledged with each of said banks 500 shares of Sherwood Swan and Company, Ltd. held by Petitioner and W. R. Whitthorne jointly; subject, however, to said pledge thereof to Harrison S. Robinson to secure the payment of said note in the amount of \$35,000, and under which each of said banks absolutely and unconditionally agreed that it would look to said 500 shares of Sherwood Swan and Company, Ltd. so pledged with it for the payment of only \$100,000 amount of the indebtedness owing to it by Petitioner and said W. R. Whitthorne, or either of them, and amounts advanced by such bank to pay said note to Harrison S. Robinson, and that upon the payment of said \$100,000 of indebtedness and the payment of any amounts advanced by said bank to pay said note of [44] Harrison S. Robinson, said 500 shares of Sherwood Swan and Company, Ltd. would be free from pursuit on account of any and all indebtedness owing to it by Petitioner and W. R. Whitthorne, or either of them.

3. Each of said banks paid one-half of said indebtedness owing to Harrison S. Robinson and prior to December 16, 1936, Petitioner and W. R. Whitthorne paid to each of said banks the amount advanced by it to pay said indebtedness to Harrison S. Robinson and paid \$10,933.67 on account of the principal of said \$100,000 of said indebtedness owing to it by Petitioner and W. R. Whitthorne. That in connection with the cancellation and settlement of indebtedness on December 16, 1936, referred to in the notice of deficiency attached hereto as Exhibit A, Petitioner and W. R. Whitthorne paid to each of said banks the remaining balance of said \$100,000. That consequently the release of said 500 shares was within the contemplation of said agreement of March 12, 1930.

4. That after said cancellation and settlement of indebtedness on December 16, 1936, Petitioner's assets (other than said 500 shares of Sherwood Swan and Company, Ltd.) consisted of:

(i) Said ranch situated in Madera County;
and

(ii) An open book account due from Sherwood Swan and Company, Ltd. in the amount of \$8,091.12;

and that the liabilities of Petitioner (other than the liabilities in the aggregate amount of \$195,000 incurred in connection with the payment of said indebtedness to said banks) consisted of: [45]

((i)) Said indebtedness to Bank of America National Trust and Savings Association in

the amount of \$10,000, secured by said ranch in Madera County;

((ii)) An indebtedness to Harry Camp in the amount of \$7,500;

((iii)) A note to David S. Wasserman in the principal amount of \$5,000;

((iv)) Accounts payable to Helen L. Swan in the amount of \$4,788, and to Charles Raphael in the amount of \$500;

((v)) Joint accounts payable by Petitioner and W. R. Whitthorne to Anglo California National Bank in the amount of \$5,000 and to Orrick, Palmer & Dahlquist in the amount of \$2,000; and

((vi)) Accrued federal income tax and California state income tax liability for the year 1936 in the estimated amount of \$2,032.03.

5. That consequently the only assets of Petitioner that were released from the burden of said indebtedness to Bank of America National Trust and Savings Association and Central National Bank of Oakland by operation of said cancellation and settlement of indebtedness on December 16, 1936, which had not already been released by said agreement of March 12, 1930, were said ranch in Madera County and said account receivable from Sherwood Swan and Company, Ltd. That on December 16, 1936, the fair market value of said ranch in Madera County was \$6,000 and that the value of the assets of Petitioner so released by said cancellation and

settlement of indebtedness was \$14,091.12. That the aggregate amount of Petitioner's liabilities on December 16, 1936 (other than said notes in the amount of \$195,000 given in connection with the payment of said cancellation and settlement of indebtedness [46] and including only Petitioner's one-half liability on joint obligations) was \$33,320.03. That in view of the foregoing Petitioner did not derive any benefit whatsoever by reason or by virtue of the said cancellation and settlement of indebtedness on December 16, 1936.

In support of assignment of error (b) above:

6. That the cost to Petitioner of said 500 shares of Sherwood Swan and Company, Ltd. was \$50,000; that at the time of the cancellation and settlement of said indebtedness on December 16, 1936, the fair market value of said shares was considerably in excess of \$50,000; that under the provisions of the Revenue Act of 1936, upon the sale of said 500 shares of Sherwood Swan and Company, Ltd. (including shares received by Petitioner in exchange therefor in connection with the tax-free reorganization of said Sherwood Swan and Company, Ltd. hereinafter referred to) Petitioner would realize a taxable gain computed on the basis of said cost of \$50,000; that if Petitioner were required to take into account in computing net income for the calendar year 1936 the amount of any benefit derived from said cancellation and settlement of indebtedness on December 16, 1936 computed (among other things) on the basis of said fair market value of

said 500 shares of Sherwood Swan and Company, Ltd.

(i) Petitioner would in fact be subject to two income taxes on the same income and value, i. e., a tax on the increase in value of said 500 shares of Sherwood Swan and Company, Ltd. over their cost on account of said benefit derived from said cancellation [47] and settlement of indebtedness and a tax on such increase on the sale of said shares; and

(ii) Petitioner would be taxed on an unrealized gain arising in connection with the increase in value of said 500 shares of Sherwood Swan and Company, Ltd. over the cost thereof not representing taxable income and not subject to taxation under the Revenue Act of 1936 or the Sixteenth Amendment to the Constitution of the United States.

That no benefit would result to Taxpayer on account of said cancellation and settlement of indebtedness on December 16, 1936 if, for the purpose of computing the same, there is assigned to said 500 shares of Sherwood Swan and Company, Ltd. a value equal to said cost thereof in the amount of \$50,000.

In support of assignment of error (c) above:

7. That immediately after the cancellation and settlement of indebtedness on December 16, 1936, referred to in said notice of deficiency, a copy of

which is attached hereto and marked Exhibit A, Petitioner's assets consisted of:

(i) 500 shares of Sherwood Swan and Company, Ltd. having a fair market value of not in excess of \$148,092.50;

(ii) Said ranch in Madera County having a fair market value of \$6,000;

(iii) Accounts receivable owing by Sherwood Swan and Company, Ltd. in the amount of \$8,091.12;

and the liabilities of Petitioner consisted of:

((i)) Joint note of Petitioner and W. R. Whitthorne to the Anglo California National Bank in the principal amount of \$175,000;

((ii)) Joint note of Petitioner and W. R. Whitthorne to the Central Company in the principal amount of \$20,000; [48]

((iii)) Note of Petitioner to Bank of America National Trust and Savings Association having an unpaid principal balance of \$10,000, secured by a mortgage on said ranch in Madera County;

((iv)) Note of Petitioner to D. S. Wasserman in the amount of \$5,000;

((v)) Indebtedness of Petitioner to Harry Camp in the principal amount of \$7,500;

((vi)) Accounts payable of Petitioner to Helen L. Swan in the amount of \$4,788 and to Charles Raphael in the amount of \$500;

((vii)) Joint account payable of Petitioner

and said W. R. Whitthorne to Orrick, Palmer & Dahlquist in the amount of \$2,000;

((viii)) Joint obligation of Petitioner and said W. R. Whitthorne to Anglo California National Bank in the amount of \$5,000; and

((ix)) Accrued federal and California state income tax of Petitioner for the year 1936 (including taxes on income on benefit from cancellation of indebtedness) in the approximate amount of \$9,125.48.

That the aggregate value of said assets of Petitioner was \$162,183.62 and that the aggregate amount of Petitioner's said liabilities (including, in the case of joint obligations, only Petitioner's one-half share thereof) was \$137,913.48, and that the amount by which the value of Petitioner's said assets exceeded the amount of his said liabilities was \$24,270.14.

That by reason of the foregoing, if Petitioner derived any benefit from said cancellation and settlement of indebtedness on December 16, 1936, such benefit was not in excess of \$24,270.14.

In support of assignment of error (d) above:

8. That during the calendar year 1936 Petitioner [49] did not sell or enter into any contract to sell any shares of Sherwood Swan and Company, Ltd., except as is hereinafter more particularly set forth in this paragraph 8. That prior to December 21, 1936 Petitioner held 500 shares of Sherwood Swan and Company, Ltd. and that the cost of said shares

to Petitioner was \$50,000. That on December 21, 1936, in connection with the tax-free reorganization of Sherwood Swan and Company, Ltd. Petitioner exchanged said 500 shares of Sherwood Swan and Company, Ltd. for 15,000 Class A shares and 22,500 common shares of Sherwood Swan and Company, Ltd. That at the time of said exchange the fair market value of said 15,000 Class A shares was \$105,000 and the fair market value of said 22,500 common shares was not in excess of \$43,092.50. That the portion of said cost of \$50,000 allocable to said 15,000 Class A shares was not less than \$35,450.81. That on November 18, 1936, Petitioner entered into a contract with Albert Gersten and Robert E. Hill, doing business under the firm name and style of "Robert N. Miller & Co." for the sale to said purchasers of 12,500 Class A shares of Sherwood Swan and Company, Ltd. at a price of \$7 per share and a total price of \$87,500. That said purchasers, pursuant to said contract, during the calendar year 1936 purchased from Petitioner 6,250 of said Class A shares and paid therefor to Petitioner a total of \$43,750, and during the calendar year 1937 purchased 6,250 of said Class A shares and paid therefor to Petitioner a total of \$43,750. That consequently, during [50] the calendar year 1936, Petitioner sold only 6,250 of said Class A shares for said total purchase price of \$43,750. That the cost allocable to said 6,250 Class A shares was not in excess of \$14,771.17 and that the gain derived from

the sale thereof by Petitioner was not in excess of \$28,978.83.

In support of assignment of error (e) above:

Petitioner obtained extensions to June 1, 1937, to file his return for the calendar year 1936. Petitioner verily believes that said return was filed by him on June 1, 1937. That said return was prepared for Petitioner by his accountants, Messrs. Barrow, Wade, Guthrie & Co., Certified Public Accountants. That by reason of the complexity of the matters covered by said return a considerable amount of time was required to prepare it. That as soon as said return had been prepared Petitioner signed and verified it and filed it with the Collector of Internal Revenue.

Wherefore, Petitioner prays that this Board may hear the proceeding and determine that the deficiency due from the Petitioner for the year 1936 is \$3,318.74 and that there is no penalty due from Petitioner for said year.

HILLYER BROWN

CHAS. L. BARNARD

Counsel for Petitioner. [51]

State of California,

City and County of San Francisco—ss.

Sherwood Swan, being duly sworn, says that he is the Petitioner above named; that he has read the foregoing Petition, and is familiar with the

statements contained therein, and that the facts stated are true.

SHERWOOD SWAN

Subscribed and sworn to before me this 12th day of January, 1940.

[Seal]

ANNE F. SWIFT,

Notary Public in and for the City and County of San Francisco, State of California. [52]

EXHIBIT A

Treasury Department
Internal Revenue Service
San Francisco, Calif.

Oct. 20, 1939.

Office of
Internal Revenue Agent in Charge
433 Federal Office Building
San Francisco Division
IRA:90-D
LB

Mr. Sherwood Swan,
244 Lakeside Drive,
Oakland, California.

Sir:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1936, discloses a deficiency of \$44,854.91 and \$2,242.74 in penalty, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Room 433, Federal Office Building, Civic Center, San Francisco, California, for the attention of Conference Section. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,

Commissioner,

By: F. M. HARLESS

Internal Revenue Agent in
Charge.

H.F.B.

Enclosures:

Statement

Form of Waiver [53]

STATEMENT

San Francisco

IRA :90-D

LB

Mr. Sherwood Swan,
244 Lakeside Drive,
Oakland, California.

Tax Liability for the Taxable Year Ended
December 31, 1936.

	Liability	Assessed	Deficiency
Income Tax	\$44,854.91	None	\$44,854.91
Penalty	\$ 2,242.74	None	\$ 2,242.74

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated January 6, 1939, to your protest dated April 14, 1939 and to the statements made at the conference held on May 16, 1939.

Inasmuch as your income tax return was not filed within the time prescribed by law or prescribed by the Commissioner in pursuance of law, five per centum of the tax has been added thereto in accordance with the provisions of Section 291, Revenue Act of 1936.

ADJUSTMENTS TO NET INCOME

Net income (loss) as disclosed by return.....		\$(14,326.19)
Unallowable deductions and additional income		
(a) Forgiveness of indebtedness.....	\$80,009.13	
(b) Capital gain increased.....	22,225.36	
(c) Interest	32,575.52	134,810.01
	<hr/>	<hr/>
Net income adjusted.....		\$120,483.82
		<hr/>

EXPLANATION OF ADJUSTMENTS

(a) On December 16, 1936, there was effected a settlement of the loan liabilities of yourself and W. R. Whitthorne, to the Central National Bank of Oakland, and the Bank of America N. T. & S. A., whereby principal indebtedness aggregating \$339,147.65 was cancelled in consideration of the payment of \$175,000.00 cash, the execution of a new promissory note of \$20,000.00 and the transfer of certain stock pledged as collateral on the loans.

Reportable profit on this transaction has been computed as follows:

Creditor	Total loan Liabilities	Sherwood Swan	W. R. Whitthorne
Bank of America N.T. & S.A.....	\$65,000.00	\$65,000.00	\$
Bank of America.....	89,066.33	44,533.16	44,533.17
Total	<u>\$154,066.33</u>	<u>\$109,533.16</u>	<u>\$44,533.17</u>
Payments:			
Cash	\$100,000.00	\$50,000.00	\$50,000.00
2071 shares Hale Brothers Realty Company	34,564.69	34,564.69	
1225 shares Wasserman-Gattman Co.	No value	—	—
2000 shares Swan's.....	No value		
Total	<u>\$134,564.69</u>	<u>\$84,564.69</u>	<u>\$50,000.00</u>
Profit realized	\$ 19,501.64	\$24,968.47	\$(5,466.83)

There is omitted from this calculation accrued but unpaid interest for the current year and prior years of \$35,773.47 and a loan liability of the Wasserman-Gattman Company of \$6,233.24 for which Swan and Whitthorne had only a contingent liability.

Creditor	Total loan Liabilities	Sherwood Swan	W. R. Whitthorne
Central National Bank of Oakland...	\$165,081.32	\$82,540.66	\$82,540.66
Central National Bank of Oakland...	20,000.00	20,000.00	
	<u>\$185,081.32</u>	<u>\$102,540.66</u>	<u>\$82,540.66</u>
			[55]
Amounts brought forward.....	<u>\$185,081.32</u>	<u>\$102,540.66</u>	<u>\$82,540.66</u>
Payments:			
Cash	\$ 75,000.00	\$ 37,500.00	\$37,500.00
New note of Swan and Whitthorne	20,000.00	10,000.00	10,000.00
Total	<u>\$ 95,000.00</u>	<u>\$ 47,500.00</u>	<u>\$47,500.00</u>
Profit realized	<u>\$ 90,981.32</u>	<u>\$ 55,040.66</u>	<u>\$35,040.66</u>
Total profit through both transactions	<u>\$109,582.96</u>	<u>\$ 80,009.13</u>	<u>\$35,040.66</u> <u>\$(5,466.83)</u>

\$27,033.72 of interest due the Central National Bank of Oakland is omitted from the profit computation.

In effecting the settlement the Central National Bank of Oakland released 500 shares of Sherwood Swan and Company, Ltd., and the Bank of America also released 500 shares of Sherwood Swan and Company, Ltd., which had been deposited by the joint debtors. However the Bank of America withheld and assumed title to 1225 shares of Wasserman-Gattman Company, 2000 shares of Swan's and 2071 shares of Hale Brothers Realty Company. To effect this transfer a pledgee's sale was held and the creditor ostensibly bought in these stocks for \$96,073.14, which represented the unpaid balance of the Bank of America loans plus accrued interest. However, at this time stocks in the Wasserman-Gattman Company and Swan's were entirely worthless while the market value of the 2071 shares of

Hale Brothers Realty Company stock was \$34,564.69. Since the transaction was negotiated and agreed to on the basis of a cancellation of the unpaid note balances, over and above the value of the stocks surrendered, the pledge sale at the artificial figure of \$96,073.14 is disregarded; credit is given for a payment by W. R. Whitthorne and yourself equivalent to \$34,564.69, the market value of 2071 shares of Hale Brothers Realty Company stock and the unpaid balance of \$19,501.64 is included as part of the profit realized on the forgiveness of indebtedness.

The benefit from cancellation of your indebtedness in the amount of \$80,009.13 as shown is held to be taxable income in accordance with Article 22(a)-14 of Treasury Regulations 94 and Walker v. Com. 88 Fed. (2) 170. [56]

(b) Your reportable capital gain is revised as follows:

Security	Date Acquired	Cost or Basis	Proceeds	Profit or Loss
(1) One-half interest in 1225 shares Wasser- man-Gattman Com- pany	12/ 3/27	None	None	None
(1) One-half interest in 2000 shares Swan's.....	11/10/28	None	None	None
(1) 2071 shares Hale Brothers Realty Company	Prior to 12/16/26	\$14,096.01	\$34,546.69	\$20,468.68
One-half interest in 1000 shares Sher- wood Swan and Company, Ltd.	Prior to 12/ 2/26	\$42,365.00	\$175,000.00	\$132,635.00

	Taxpayer's share of profit or loss	Per cent reportable under Section 117	Amount Reportable
Wasserman-Gattman Company	None	None	None
Swan's	None	None	None
Hale Brothers Realty Company.....	\$20,468.68	30%	\$ 6,140.60
Sherwood Swan and Company.....	66,317.50	30%	19,895.25
Total reportable			\$26,035.85
As shown in your return.....			3,810.49
Increase			\$22,225.36

(1) The proceeds of the stocks transferred to the Bank of America under the debt settlement as outlined in the previous issue are deemed to be the fair market value of such stocks at the time of the transfer. No proceeds are shown for the stock of the Wasserman-Gattman Company and Swan's which were worthless at the time. And since such

[57]

stocks became worthless prior to the taxable year, the stocks had no basis and no loss on the transfer is allowable. The holding that such stocks were worthless in based on the fact that you claimed a deduction due to worthlessness of Wasserman-Gattman Company stock in your 1933 income tax return which was disallowed by the Commissioner on the ground that this stock became worthless in the year 1930. Since the only asset of Swan's, Inc. was holdings of stock in the Wasserman-Gattman Company it too is held to have become worthless in 1930.

(c) On your return a deduction \$32,212.28 was claimed for interest accrued on your separate loan of \$65,000.00 and \$363.24 on your joint loan both due the Bank of America N. T. & S. A. Since it is held that neither loans nor interest were paid but were cancelled upon payment of an amount and transfer of stock values, which did not, in the aggregate, equal the principal of the loans the deduction of \$32,575.52 for interest is denied.

COMPUTATION OF TAX

Net income adjusted.....		\$120,483.82
Less:		
Personal exemption	\$2,500.00	
Credit for dependents.....	400.00	2,900.00
		<hr/>
Balance (surtax net income).....		\$117,583.82
Less:		
. Earned income credit.....		1,176.67
		<hr/>
Net income subject to normal tax.....		\$116,407.15
		<hr/>
Normal tax at 4% on \$116,407.15.....	\$	4,656.29
Surtax on \$117,583.82.....		40,198.62
		<hr/>
Correct income tax liability.....	\$	44,854.91
		<hr/>
Income tax assessed:		
Original, account No. 684393—First California		None
Deficiency of income tax.....	\$	44,854.91
Penalty of 5%, Section 291, Revenue Act of 1936	\$	2,242.74
Penalty assessed		None
		<hr/>
Penalty due	\$	2,242.74
		<hr/>

[Endorsed]: Filed Jan. 16, 1940. [58]

[Title of Board and Cause—Docket No. 101190.]

FIRST AMENDMENT TO PETITION

The petition of Sherwood Swan filed in the above entitled matter for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols IRA:90-

D/LB), dated October 20, 1939, is amended as follows:

I.

Paragraph III of said petition is amended to read:

“The taxes in controversy are income taxes for the calendar year 1936 in the amount of \$41,536.17 and penalty in the amount of \$2,242.74.

Dated: January 17, 1940.

HILLYER BROWN

CHAS. L. BARNARD

Counsel for Petitioner. [59]

State of California,
County of Alameda—ss.

Sherwood Swan, being duly sworn, says that he is the Petitioner above named; that he has read the foregoing First Amendment to Petition, and is familiar with the statements contained therein, and that the facts stated are true.

SHERWOOD SWAN

Subscribed and sworn to before me this 17th day of January, 1940.

[Seal]

BESSIE E. COTTON,

Notary Public in and for the County of Alameda,
State of California.

[Endorsed]: Filed Jan. 19, 1940. [60]

[Title of Board and Cause—Docket No. 101190.]

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition, as amended, filed by the above-named petitioner admits and denies as follows:

I. Admits the allegations contained in paragraph I of the petition as amended.

II. Admits the allegations contained in paragraph II of the petition as amended.

III. Admits that the tax in controversy is income tax for the calendar year 1936; denies the remaining allegations contained in paragraph III of the petition as amended.

IV(a) to (e), incl. Denies that the Commissioner committed errors as alleged in subparagraphs (a) to (e) of paragraph IV of the petition as amended.

[61]

V-1. For lack of materiality, denies all allegations contained in subparagraph 1 of paragraph V of the petition as amended.

V-2. For lack of materiality, denies all allegations contained in subparagraph 2 of paragraph V of the petition as amended.

V-3. Admits that on December 16, 1936, there was a cancellation and settlement of the indebtedness, referred to in the notice of deficiency attached to the petition as Exhibit A; denies the remaining

allegations contained in subparagraph 3 of paragraph V of the petition as amended.

V-4 and V-5. Denies all allegations contained in subparagraphs 4 and 5 of paragraph V of the petition as amended.

V-6. Admits that the cost to petitioner of 500 shares of Sherwood Swan and Company, Ltd., stock was \$50,000; that at the time of the cancellation and settlement of said indebtedness on December 16, 1936, the fair market value of said shares was considerably in excess of \$50,000; denies the remaining allegations contained in subparagraph 6 of paragraph V of the petition as amended.

V-7. Admits that there was a cancellation and settlement of indebtedness on December 16, 1936, referred to in the notice of deficiency, a copy of which is attached to the petition and marked Exhibit A; denies the remaining allegations contained in subparagraph 7 of paragraph V of the petition as amended. [62]

V-8. Admits that prior to December 21, 1936, petitioner held 500 shares of Sherwood Swan and Company, Ltd., stock; that the cost of said shares to petitioner was \$50,000; that on December 21, 1936, in connection with a tax-free reorganization of Sherwood Swan and Company, Ltd., petitioner exchanged said 500 shares of Sherwood Swan and Company, Ltd., stock for 15,000 Class A shares and 22,500 common shares of Sherwood Swan and Company, Ltd., stock; that on November 18, 1936, petitioner entered into a certain contract with Albert

Gersten and Robert E. Hill, doing business under the firm name and style of "Robert N. Miller & Co.," for the sale to said purchasers of certain Class A shares of Sherwood Swan and Company, Ltd., at a price of \$7 per share; denies the remaining allegations contained in subparagraph 8 of paragraph V of the petition as amended.

VI. Admits that petitioner obtained extensions to June 1, 1937, to file his income tax return for the calendar year 1936; denies the remaining allegations set forth in the petition as amended under the heading "In support of assignment of error (e) above."

VII. Denies generally and specifically each and every allegation in the petition as amended not hereinbefore admitted, qualified or denied. [63]

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

J. P. WENCHEL,

Chief Counsel, Bureau of Internal Revenue.
Of Counsel,

ALVA C. BAIRD,

T. M. MATHER,

HARRY R. HORROW,

Special Attorneys,

Bureau of Internal Revenue.

HRH:sob 2/9/40

[Endorsed]: Filed Feb. 16, 1940. [64]

[Title of Board and Cause—Docket No. 101190.]

SECOND AMENDMENT TO PETITION

The petition of Sherwood Swan filed in the above entitled manner for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (Bureau symbols IRA:90-D/LB), dated October 20, 1939, is amended as follows:

I.

Paragraph III of said Petition is amended to read:

“The taxes in controversy are income taxes for the calendar year 1936 in the amount of \$43,381.44 and penalty in the amount of \$2,242.74.”

II.

Paragraph IV(c) of said Petition is amended to read:

“(c) Even if the benefit from the cancellation of said indebtedness is applicable to the year 1936 and not the year 1930, and even if cancellation of indebtedness under the circumstances hereinafter alleged constituted taxable income, there was no taxable net income, and consequently the Commissioner erred in finding that the income to Petitioner from said cancellation was in the amount of \$80,009.13.” [65]

III.

Paragraph IV(d) of said Petition is amended to read:

“(d) The Commissioner erred in finding that during the calendar year 1936 Petitioner sold a one-half interest in 1,000 shares of Sherwood Swan and Company, Ltd. and in finding that the cost or other basis of said 1,000 shares was \$42,365 and in finding that said 1,000 shares were sold for an aggregate sum of \$175,000, or any other sum whatsoever, and in finding that Petitioner’s share of the profit from such sale was \$66,317.50 or any other sum whatsoever. However, Petitioner sold, during said calendar year 1936, 6,250 Class A shares of Sherwood Swan and Company, Ltd. for an aggregate selling price of \$43,750. The cost allocable to said 6,250 Class A shares was \$20,833.33 and taxpayer realized a gain of \$22,916.67 on said sale of Class A shares.”

IV.

Paragraph IV of said Petition is amended by inserting a new subparagraph at the end thereof to be known as subparagraph (f) to read as follows:

“(f) The Commissioner erred in finding that during the year 1936 the Petitioner received a capital gain of \$20,468.68 of any other sum upon the sale of 2,071 shares of Hale Bros. Realty Company stock and that Petitioner received a taxable profit on such transaction of \$6,140.60 or any other sum.” [66]

V.

Paragraph V-4 of said Petition is amended to read:

“4. That after said cancellation and settlement of indebtedness on December 16, 1936, Petitioner's assets (other than said 500 shares of Sherwood Swan and Company, Ltd. consisted of:

(i) Said ranch situated in Madera County; and

(ii) An open book account due from Sherwood Swan and Company, Ltd. in the amount of \$9,835.12;

and that the liabilities of Petitioner (other than the liabilities in the aggregate amount of \$195,000 incurred in connection with the payment of said indebtednesses to said banks) consisted of:

((i)) Said indebtedness to Bank of America National Trust and Savings Association in the amount of \$10,000, secured by said ranch in Madera County;

((ii)) An indebtedness to Harry Camp in the amount of \$7,500;

((iii)) A note to David S. Wasserman in the principal amount of \$5,000;

((iv)) Accounts payable to Helen L. Swan in the amount of \$4,788, to Charles Raphael in the amount of \$500, to T. E. Louis in the amount of \$725.10, to R. L. Underhill

in the amount of \$200, to George D. Roberts in the amount of \$500, to McKinstry, Haber & Coombes in the amount of \$300, and to the Moose Club in the amount of \$58.50;

((v)) Joint accounts payable by Petitioner and W. R. Whitthorne to Anglo California National Bank in the amount of \$5,000 and to Orrick, Palmer & Dahlquist in the amount of \$2,000; and

((vi)) Accrued federal income tax and California state income tax liability for the year 1936 in the estimated amount of \$764.35." [67]

VI.

Paragraph V-5 of said Petition is amended to read:

"5. That consequently the only assets of Petitioner after operation of said cancellation and settlement of indebtedness on December 16, 1936, which had not already been released by said agreement of March 12, 1930, were said ranch in Madera County and said account receivable from Sherwood Swan and Company, Ltd. That on December 16, 1936, the fair market value of said ranch in Madera County was \$6,000; that said ranch continued to be subject to an indebtedness of \$10,000 to Bank of America National Trust and Savings Association secured by a deed of trust thereon; and that the value of the assets of Petitioner after said

cancellation and settlement of indebtedness was \$15,835.12. That the aggregate amount of Petitioner's liabilities on December 16, 1936 (other than said notes in the amount of \$195,000 given in connection with the payment of said cancellation and settlement of indebtedness and including only Petitioner's one-half liability on joint obligations) was \$33,835.95. That in view of the foregoing, Petitioner did not derive any benefit whatsoever by reason or by virtue of the said cancellation and settlement of indebtedness on December 16, 1936."

VII.

That paragraph V-7 of said Petition is amended to read:

"7. That immediately after the cancellation and [68] settlement of indebtedness on December 16, 1936, referred to in said notice of deficiency, a copy of which is attached hereto and marked 'Exhibit A,' Petitioner's assets consisted of:

(i) 500 shares of Sherwood Swan and Company, Ltd. having a fair market value of not in excess of \$105,000.

(ii) Said ranch in Madera County having a fair market value of \$6,000;

(iii) Accounts receivable owing by Sherwood and Company, Ltd. in the amount of \$9,835.12;

and the liabilities of Petitioner consisted of:

((i)) Joint note of Petitioner and W. R. Whitthorne to The Anglo California National Bank in the principal amount of \$175,000;

((ii)) Joint note of Petitioner and W. R. Whitthorne to the Central Company in the principal amount of \$20,000;

((iii)) Note of Petitioner to Bank of America National Trust and Savings Association having an unpaid principal balance of \$10,000, secured by a mortgage on said ranch in Madera County;

((iv)) Note of Petitioner to D. S. Wasserman in the amount of \$5,000;

((v)) Indebtedness of Petitioner to Harry Camp in the principal amount of \$7,500; [69]

((vi)) Accounts payable of Petitioner to Helen L. Swan in the amount of \$4,788 and to Charles Raphael in the amount of \$500, to T. E. Louis in the amount of \$725.10, to R. L. Underhill in the amount of \$200, to George D. Roberts in the amount of \$500, to McKinstry, Haber & Coombes in the amount of \$300, and to the Moose Club in the amount of \$58.50;

((vii)) Joint account payable of Petitioner and said W. R. Whitthorne to Orrick, Palmer & Dahlquist in the amount of \$2,000; and

((viii)) Joint obligation of Petitioner and said W. R. Whitthorne to Anglo California National Bank in the amount of \$5,000; and

((ix)) Accrued federal and California state income tax of Petitioner for the year 1936 in the approximate amount of \$764.35.

That the aggregate value of said assets of Petitioner was \$120,835.12 and that the aggregate amount of Petitioner's said liabilities (including, in the case of joint obligations, only Petitioner's one-half share thereof) was \$131,335.95, and that the amount by which the value of Petitioner's said liabilities exceeded the amount of his said assests was \$10,500.83.

That by reason of the foregoing, Petitioner did not derive any benefit from said cancellation and settlement of indebtedness on December 16, 1936."

VIII.

Paragraph V-8 of said Petition is amended to read:

"8. That during the calendar year 1936 Petitioner did not sell or enter into any contract to sell any shares of [70] Sherwood Swan and Company, Ltd., except as is hereinafter more particularly set forth in this paragraph 8. That prior to December 21, 1936 Petitioner held 500 shares of Sherwood Swan and Company, Ltd. and that the cost of said shares to Petitioner was \$50,000. That on

December 21, 1936, in connection with the tax-free reorganization of Sherwood Swan and Company, Ltd. Petitioner exchanged said 500 shares of Sherwood Swan and Company, Ltd. for 15,000 Class A shares and 22,500 common shares of Sherwood Swan and Company, Ltd. That at the time of said exchange the fair market value of said 15,000 Class A shares was \$105,000 and said 22,500 common shares did not have any fair market value. That the entire cost of said stock, to-wit, \$50,000 is allocable to said 15,000 Class A shares. That on November 18, 1936, Petitioner entered into a contract with Albert Gersten and Robert E. Hill, doing business under the firm name and style of 'Robert N. Miller & Co.' for the sale to said purchasers of 12,500 Class A shares of Sherwood Swan and Company, Ltd. at a price of \$7 per share and a total price of \$87,500. That said purchasers, pursuant to said contract, during the calendar year 1936 purchased from Petitioner 6,250 of said Class A shares and paid therefor to Petitioner a total of \$43,750, and during the calendar year 1937 purchased 6,250 of said Class A shares and paid therefor to Petitioner a total of \$43,750. That consequently, during the calendar year 1936, Petitioner sold only 6,250 of said Class A shares for said total purchase price of \$43,750. That the cost allocable [71] to said 6,250 Class A shares was not in excess of \$20,833.33 and that the gain

derived from the sale thereof by Petitioner was not in excess of \$22,916.67.”

IX.

Paragraph V of said Petition is amended by adding at the end thereof a new subparagraph to be known as subparagraph (f) to read as follows:

“(f) That on the date of sale of Petitioner’s 2071 shares of Hale Bros. Realty Company stock, to-wit, December 16, 1936, the fair market value of said shares was not in excess of \$8,284; that as a result of said sale Petitioner suffered a loss of \$5,812.01 and a reportable capital net loss of \$1,743.60.

X.

The prayer of said Petition is amended to read:

“Wherefore, Petitioner prays that this Board may hear the proceeding and determine that the deficiency due from the Petitioner for the year 1936 is not in excess of \$1,473.47, and that there is no penalty due from Petitioner for said year.”

ROBERT W. MACDONALD

Counsel for Petitioner

1600 Financial Center Bldg.

Oakland, California [72]

State of California,
County of Alameda—ss.

Sherwood Swan, being duly sworn, deposes and says that he is the Petitioner above named; that he has read the foregoing Second Amendment to Petition, and is familiar with the statements contained therein, and that the facts stated are true.

SHERWOOD SWAN

Subscribed and sworn to before me this 17th day of October, 1940.

A. MC CREADY,

Notary Public in and for the
County of Alameda, State
of California.

(Seal)

[Endorsed]: Filed Oct. 21, 1940. [73]

[Title of Board and Cause—Docket No. 101190.]

ANSWER TO SECOND AMENDMENT
TO PETITION

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of *Internal*, and for answer to the Second Amendment to Petition filed by the above-named petitioner, admits and denies as follows:

I.

Admits the allegations contained in paragraph I of Second Amendment to Petition except the allegation as to the amount of income taxes in controversy, which is denied.

II.

Denies the allegations contained in paragraph II of the Second Amendment to Petition.

III.

Denies the allegations contained in paragraph III of the Second Amendment to Petition.[74]

IV.

Stricken.

V.

Denies the allegations contained in paragraph V of the Second Amendment to the Petition.

VI.

Denies the allegations contained in paragraph VI of the Second Amendment to the Petition.

VII.

Denies the allegations contained in paragraph VII of the Second Amendment to the petition.

VIII.

Denies the allegations contained in paragraph VIII of the Second Amendment to the Petition.

IX.

Stricken.

X.

Denies generally and specifically each and every allegation in the Second Amendment to the petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and that the petitioner's appeal be denied.

J. P. WENCHEL,

Chief Counsel,

Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD,

Division Counsel.

T. M. MATHER,

Special Attorney,

Bureau of Internal Revenue.

[Endorsed]: Filed Oct. 31, 1940. [75]

[Title of Board and Cause—Docket Nos. 101189, 101190.]

Promulgated August 13, 1941.

1. When a solvent taxpayer settles a debt for less than the full amount, the saving as a general rule is income.
2. The value of the taxpayer's assets held, upon the evidence, not to establish insolvency.
3. In the settlement of a secured debt for less than its amount, it is not the release of the

pledged property from the lien that constitutes the realization of income, it is the obliteration of the debt itself.

4. The basis for determining gain on the sale of preferred stock received with common in a tax-free exchange held to be an allocable part of the cost of the original shares given up in the exchange, since the evidence shows that both preferred and common had value when received.

5. Under a contract made in 1936 to sell 25,000 shares on prescribed terms, the shares to be delivered as payment was made for each share, 12,500 shares were delivered in 1936 and 12,500 in 1937, within the contract period. Held, the sale of the last 12,500 was in 1937 and the gain therefrom is not within 1936 income.

Robert W. MacDonald, Esq., for the petitioners.

Thomas M. Mather, Esq., for the respondent.

The Commissioner determined deficiencies for 1936 of \$9,902.53 in the income tax of W. R. Whitthorne and a penalty of \$495.12, and of \$44,854.91 in the income tax of Sherwood Swan and a penalty of \$2,242.74. Petitioners assail the determinations (1) of gain in the settlement of debts in 1936; (2) of gain in the sale of shares received in a tax-free exchange; and (3) of a delinquency penalty for failure to file income tax returns in time.

FINDINGS OF FACT.

Minnie L. Whitthorne and Eva Whitthorne are executrices of the estate of W. W. Whitthorne, who died July 25, 1940. W. R. Whit- [76]thorne and Sherwood Swan (called petitioners), residents of Oakland, California, filed their returns in the first district of California. They were associated in business enterprises for many years. Each had acquired at a cost of \$50,000 one-half of the outstanding 1,000 shares of Sherwood Swan & Co., Ltd. (old company), which operated a market in Oakland.

In March 1930 petitioners were indebted to Harrison S. Robinson on their joint and several promissory note for \$35,000, secured by 1,000 old company shares. They were indebted to David S. Wasserman on their joint purchase money note for \$100,000, secured by 1,000 shares of Wasserman-Gattmann Co., one-half being owned by each. To the Central National Bank of Oakland they owed \$250,000 on their joint and several note secured by 6,000 shares of the Hale Bros. Stores, Inc. To the Bank of America they owed \$100,000 on their joint and several note secured by 2,071 shares of the Hale Bros. Realty Co. To the Central National Bank Swan alone owed an unsecured debt of \$20,000; and to the Bank of America he owed an unsecured debt of \$65,000 and a debt of \$10,000 secured by a mortgage on a ranch.

Pursuant to an agreement between petitioners and the note holders on March 12, 1930, the two banks paid off petitioners' note to Robinson, later being

reimbursed therefor. Petitioners' shares of the old company which were pledged to Robinson were then released, and 500 were pledged with each bank as security for \$100,000 of petitioners' debts to it. The banks agreed not to

* * * look to the securities thus pledged to us in equal amounts for more than the \$100,000 each, * * *.

* * * it was not intended, however, to forgive the indebtedness due by the individuals in excess of this amount.

On December 15, 1936, petitioners on their joint and several demand note borrowed \$175,000 from the Anglo-California National Bank of San Francisco. The Central National Bank was in receivership, and on the same date petitioners made an agreement with the receiver under which they paid him \$75,000 and gave their non-interest-bearing promissory note for \$20,000, payable \$4,000 a year, in full compromise settlement of:

Note signed by—	Face of Note	Balance due
Both	\$100,000.00	\$13,080.32
Do.....	15,000.00	15,000.00
Do.....	85,000.00	85,000.00
Do.....	66,000.00	1.00
Swan	25,664.67	25,664.67
Both	73,369.05	73,369.05
<hr/>		
Total.....	365,033.72	212,115.04

[77]

Accrued interest was due on the notes, and \$5,664.67 and \$21,369.05, respectively, of the face amounts of the last two notes represented unpaid interest on

the original loans. The aggregate original loans represented by the notes were \$185,081.32, of which petitioners were jointly indebted for \$165,081.32 and Swan was individually indebted for \$20,000. The notes were secured by 500 old company shares and by 2,000 shares of Swan's, a corporation, 1,725 shares of Wasserman-Gattmann, and a \$50,000 insurance policy of the life of Swan. The 2,000 shares of Swan's, the 1,725 shares of Wasserman-Gattmann, and the insurance policy were, in a petition for approval of the compromise offer filed with the court in the Central National Bank receivership proceeding, described as worthless. The settlement was approved by the court, and the 500 old company shares were released from pledge.

On December 16, 1936, petitioners were indebted to the Bank of America on notes aggregating \$196,073.14, secured by 500 old company shares, 2,071 shares of the Hale Bros. Realty Co., 2,000 shares of Swan's, a corporation, and 1,725 shares of the Wasserman-Gattmann Co. Of these notes, \$89,066.33 was the aggregate principal amount of joint notes of petitioners and \$65,000 was the principal of a separate note of Swan. On that date a sale of the pledges was held at which petitioners bid in the 500 old company shares for \$100,000 and the Bank of America bid in the remaining securities for \$96,073.14. The 2,071 Hale shares were worth \$34,564.69 and the other shares were worthless. Petitioners paid the bank \$100,000. The 500 old company shares were released from pledge, and, with

the other 500 shares released by the Central National Bank, were placed with the trust department of the Anglo-California Bank.

On December 16, 1936, petitioners' liabilities were as follows:

	Whitthorne	Swan
Joint note to Central Co., \$20,000.....	\$10,000.00	\$10,000.00
Note to Bank of America, secured by mortgage on Swan's ranch.....	10,000.00
Joint notes to Anglo-California Bank, \$175,000 and \$5,000.....	90,000.00	90,000.00
Note due David S. Wasserman.....	5,000.00
Accounts payable	1,500.00	15,571.60
Unpaid taxes	764.35
Total.....	101,500.00	131,335.95

On the same date each owned 500 old company shares. Whitthorne owned nothing else. Swan owned in addition a claim of \$9,835.12 against the old company and the mortgaged ranch, which had a value of \$6,000. After the settlement of petitioners' indebtedness to the banks, Whitthorne's assets exceeded his liabilities by at least \$35,040.66 and Swan's assets exceeded his liabilities by at least \$80,009.13. [78]

Pursuant to an agreement with the Anglo-California Bank under which the \$175,000 loan had been made to petitioners, the 1,000 old company shares were surrendered by the bank's trust department, and in a tax-free exchange the Sherwood Swan Co. Ltd. (new company), issued therefor

30,000 class A shares of a par value of \$10 each and 45,000 common shares of no par value, representing its entire capital stock. Each petitioner exchanged his 500 old company shares for one-half of the new shares. On November 18, 1936, petitioners and Robert N. Miller & Co. had made a contract contemplating this reorganization. Miller & Co. had agreed to purchase 25,000 class A shares for \$175,000, or at \$7 each; to deposit \$25,000 and securities of a value of \$35,000 with the bank as trustee as security for payment of the price; and to pay \$24,500 to the trustee within 3 days after shares should be available for delivery. Thereupon Miller & Co. became entitled to the delivery of 3,500 shares. The remainder of the purchase price was payable in installments within a 90-day period, the purchaser being entitled upon each payment to delivery of one share for each \$7 paid. It agreed to pay the trustee, in addition to the \$175,000 recited price:

* * * an amount equal to the accrued dividends on each of the 25,000 shares from December 1, 1936, to the date of actual delivery thereof to [it].

In case Miller & Co. should fail to make full payment within the 90-day period, the trustee was directed to apply the \$25,000 and the proceeds of the sale of the securities deposited as collateral to petitioners' note due the bank, and then to deliver to Miller & Co. that number of class A shares neces-

sary to make the total number delivered to it equal to one share for each \$10 paid by it or applied by the trustee on the purchase price under the agreement. During 1936 Miller & Co. deposited the collateral, paid the following installments, and received as payment the following number of shares:

	Payment	Shares
Dec. 23.....	\$49,000.00	7,000
Dec. 26.....	21,000	3,000
Dec. 30.....	17,500	2,500
Total.....	87,500	12,500

Additional installments, completed payment of the purchase price by February 9, 1937; the remaining 12,500 shares were delivered as payments were made, and after final payment the trustee delivered the 2,500 class A and 22,500 common shares remaining with him to each petitioner. There has been no sale of common shares, but in 1937 Whitthorne transferred 4,500 to Swan, who agreed to relieve Whitthorne of liability on their joint \$20,000 note due the Central National Bank. [79]

On December 31, 1936, the new company had assets of a book value of \$858,332.19. It had liabilities of \$370,661.74; a capital stock account of \$390,000, of which \$300,000 was allocated to the 30,000 class A shares and \$90,000 to the 45,000 common shares, and a book surplus of \$97,670.45. Land was carried among the assets at a book value of \$618,674.83. In 1934, 1935, and 1936, the old company's net income and dividends were as follows:

	1934	1935	1936
Net income	\$64,025.26	\$65,834.77	\$70,052.26
Dividends	12,000.00	32,000.00	11,000.00

The class A shares of the new company are entitled to cumulative preferential annual dividends of 60 cents a share and to a further participating dividend equal to any dividend declared or paid on the common shares for the same period after the common shares shall have received a dividend of 60 cents for that period. Holders of class A shares are entitled to one vote a share, and upon liquidation shall be preferred as to assets to the extent of \$10 a share plus accumulated and unpaid dividends.

Petitioners were granted an extension of time, expiring on June 1, 1937, for filing their income tax returns for 1936. An accountant employed by them completed preparation of the returns on May 29, 1937. The returns, properly signed and sworn to, were delivered to the collector. Swan's return is stamped by the collector as filed on June 2, 1937.

The Commissioner determined that for 1936 Whitthorne received income of \$35,040.66 and Swan income of \$80,009.14 in the settlement with the Central National Bank and the Bank of America. He adopted the profit reported by them of \$66,317.50 on the sale of shares in Sherwood Swan & Co., Ltd., and included 30 percent thereof, or \$19,895.25 in the income of each. He determined penalties for failure to file their income tax returns within the time prescribed by law.

OPINION.

Sternhagen: 1. The taxpayers were in 1936 jointly indebted to Central Bank for \$165,081.32 and Swan separately owed that bank \$20,000. They compromised this aggregate indebtedness of \$185,081.32¹ for \$75,000 cash and a new joint note of \$20,000, thus relieving themselves of an aggregate of \$90,081.32, of which \$70,081.32 [80] was attributable to the joint note of \$165,081.32 and \$20,000 was attributable to Swan's separate individual note. The Commissioner determined that Whitthorne's income included the released \$35,040.66, one-half the joint note, and Swan's income included the released \$55,040.66, one-half the joint note and all of his separate note.

The taxpayers were jointly indebted to the Bank of America for \$89,066.33 and Swan separately owed that bank \$65,000. This aggregate debt was settled by the payment of \$100,000 cash and the taking by the debtor of the shares of the Hale Bros. Realty Co., Wasserman-Gattmann Co., and Swan's. The shares of the last two corporations were worthless and the shares of the Hale Bros. Realty Co. were recognized as having a value of \$34,564.69. The Commissioner determined that Whitthorne

¹The balance due on the face amount of the notes was \$212,115.04, but the Commissioner's determination treats the excess as interest and omits it from the computation. Likewise the excess of the face amount of the Bank of America notes is omitted from the computation.

realized no income in the settlement of this indebtedness and that Swan's income included the \$24,968.47 difference between his share (\$109,533.16) of the aggregate of \$154,066.33 owed and his share (\$50,000) of the amount of cash and the value (\$34,564.69) of the Hale shares paid by Swan in the settlement.

When a taxpayer settles a debt for less than the full amount, the saving, as a general rule, is income. *United States v. Kirby Lumber Co.*, 284 U. S. 1; *B. F. Avery & Sons, Inc.*, 26 B. T. A. 1393; *Highland Farms Corporation*, 42 B. T. A. 1314. The petitioners try to bring themselves within the line of cases holding that income is not realized if the debtor is insolvent before and after the settlement. Swan claims to have had a net insolvency of \$10,500.83 and Whitthorne a net worth of \$3,500. In each instance, their shares in the corporation are treated as worth \$105,000, arrived at by using a value of \$200,000 for the corporation's land. The evidence does not, in our opinion, establish insolvency of either petitioner.

The value of the petitioners' shares is not properly fixed by the value of the land on which the corporation operates the market. Other factors must be considered. In view of all the evidence, the opinions of the witnesses as to the value of the land can not be adopted. The earnings of 1935 were over \$65,000 and of 1936 over \$70,000. The dividends for 1935 were \$32,000 and for 1936 were \$11,000. The new financing was based upon a recognition of

the book value of the market property. The whole-sale price of the class A shares to the dealer was \$7 and to the public \$10. The common shares had commensurate rights which gave them substantial value. It is not necessary to find a definitive value for the corporation's shares, but *is it* clear that they were worth more than enough to show that as assets in the hands of petitioners they preclude a [81] finding of insolvency and do not affect the gain realized in the settlement of their debts.

The petitioners argue a new conception of the doctrine of realization of income in connection with a debt settlement. They say the essence of the realization is not the settlement of the debts alone, but the freeing of assets, and that such freeing of assets occurred in 1930 when the pledge of the shares was limited by the banks to \$100,000. This can not be adopted as the theory of the rule. A solvent taxpayer realizes a gain by a reduction of his debt irrespective of whether the debt is secured by a pledge or mortgage. The freeing of assets which has been regarded in the decisions as a significant fact is not the release of the pledged security from lien, but the effect of enabling the debtor to use all his assets freed from the incubus of the debt. The obliteration of the offsetting liability for debt is what constitutes the gain. If in 1930 the creditor banks had not only agreed to limit the use of the pledged shares to security for \$100,000 of the debt, but had also renounced all claim on the debtor for more than \$100,000, the

forgiveness would have been a gain, not because the lien was limited, but because the excess amount of the debt was discharged without payment. Having been realized in 1930 it would have been taxable then and not later. But it was not until 1936 that the debt was finally settled; so the resulting gain is properly taxable then.

The petitioners also make a point that the measure of the gain, according to their theory, is not the value of the assets freed, but the cost of them to the petitioners, which was \$50,000 to each. The point, however, falls with the theory. Since the release of the pledged shares from the lien is not the occasion of the gain, their particular value or cost is not determinative of the gain. The relevancy of their value when the debt is discharged is only as a factor in considering whether the extent of petitioners' assets demonstrates insolvency; and this, as has been stated, is not true.

The Commissioner's determinations of taxable gain resulting from the settlement of debts to the Central National Bank of Oakland and Bank of America are sustained.

2. The petitioners claim that in the computation of gain resulting from the sale of the new shares the basis has been erroneously distributed between the class A preferred and the common shares. The original 1,000 old company shares cost them \$100,000. The petitioners exchanged their old shares for new and agreed with Miller & Co. to sell 25,000 class A shares to it for \$175,000 on prescribed terms.

They say that in computing the gain from this transaction the basis of \$100,000 must all be assigned to the class A shares because the common shares were worthless. By such a computation [82] the basis of the shares sold would be increased and the gain correspondingly reduced, and the unsold common shares would be left with no basis, and any future sale price would be entirely gain. The Commissioner adopted for the distribution of the basis between the two classes of shares the ratio which petitioners used on their returns, viz., 50.84 percent for the preferred and 49.16 percent for the common. This is, in our opinion, the best the petitioners can demand on the evidence.

The corporation's balance sheet showed a surplus of \$97,670.45 after assigning \$390,000 to capital stock. The assets included the \$618,674.83 book value of the market property. Net income each year was about \$65,000. This was more than enough to have enabled the corporation to pay dividends equal to the first 60 cents on the preferred and the corresponding first 60 cents on the common. Additional dividends were to be equal on the two classes of shares. Other rights of the shareholders were very much alike, except the liquidation preference of the class A. The fact that the common shares were not actually sold is no indication of a lack of market or of value, when the preferred were so promptly sold at \$10 a share on the open market. The basis used by the Commissioner is sustained.

3. The petitioners contend that in 1936 they sold only 12,500 of the class A shares and that their tax may not be measured by a profit from the sale of 25,000 shares. In this we think they are correct. The contract with Miller & Co. was not a sale of the entire 25,000 shares. In fact only 12,500 were delivered in 1936 and, since this was well within the 90-day period, there was no duty of the dealer to take any more in that year. It fulfilled its contract in 1937 by taking the remaining 12,500 and paying for them in that year. It can not be said that the latter were sold in 1936 or that petitioners in that year derived the profit from their sale. They had made a contract to sell, but there is no evidence that this was intended to be an immediate sale. It is error to treat it as such. *Commissioner v. Segall*, 114 Fed. (2d) 706; *Shillinglaw v. Commissioner*, 99 Fed. (2d) 87; *Dahlinger v. Commissioner*, 51 Fed. (2d) 662; certiorari denied, 284 U. S. 673; *Stiver v. Commissioner*, 90 Fed. (2d) 505.

The gain in 1936 should be reduced to that applicable to a sale of 12,500 shares.

4. The Commissioner determined a penalty of 5 percent under section 291, Revenue Act of 1936, for failure of petitioners to file their returns on time. The evidence does not establish that the delay was due to reasonable cause and not to willful neglect, and the penalty is therefore sustained.

Decision will be entered under Rule 50. [83]

United States Board of Tax Appeals
Washington

Docket No. 101189

ESTATE OF W. R. WHITTHORNE, Deceased,
MINNIE L. WHITTHORNE and EVA
WHITTHORNE, Executrices,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Subsequent to the Board's report, promulgated August 13, 1941, the respondent filed a computation, which came on for hearing on October 1, 1941. No objections having been filed to the said computation, it is

Ordered and decided that for 1936 there is a deficiency of \$6,894.28 in income tax and a penalty of \$344.71.

Enter:

(Signed) J. M. STERNHAGEN
Member

Entered Oct. 2, 1941. [84]

United States Board of Tax Appeals
Washington

Docket No. 101190

SHERWOOD SWAN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Subsequent to the Board's report, promulgated August 13, 1941, the respondent filed a computation, which came on for hearing on October 1, 1941. No objections having been filed to the said computation, it is

Ordered and decided that for 1936 there is a deficiency of \$38,687.37 in income tax and a penalty of \$1,934.37.

Enter:

(Signed) J. M. STERNHAGEN
Member

Entered Oct. 2, 1941. [85]

In the United States Circuit Court of Appeals
for the Ninth Judicial Circuit

B.T.A. Docket No. 101189

MINNIE L. WHITTHORNE and EVA WHIT-
THORNE, Executrices, ESTATE OF W. R.
WHITTHORNE, Deceased,

Petitioners on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

PETITION FOR REVIEW

To the Honorable Judges of the United States
Circuit Court of Appeals for the Ninth Judi-
cial Circuit:

Now come Minnie L. Whitthorne and Eva
Whitthorne, Executrices of the Estate of W. R.
Whitthorne, deceased, by R. W. Macdonald, their
attorney, and respectfully show:

I.

Petitioners, Minnie L. Whitthorne and Eva
Whitthorne, are the duly appointed, qualified and
acting Executrices of the Estate of W. R. Whit-
thorne, deceased, hereinafter referred to as the tax-
payer. Petitioners herein are residents, and W. R.
Whitthorne, deceased, during his lifetime was a
resident, of the City of Piedmont, County of Ala-
meda, State of California, Northern District of

California, and their address is 324 Pacific Avenue, Piedmont, California. [86]

Respondent is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States, herein referred to as the Commissioner.

II.

The taxpayer filed an income tax return for the taxable year 1936 with the Collector of Internal Revenue for the District of Northern California, whose office is located within the Ninth Judicial Circuit, wherein the taxpayer also resides.

Taxpayer, W. R. Whitthorne, died on the 25th day of July, 1940.

III.

The Collector determined a deficiency in income tax against the taxpayer for the year 1936 in the amount of \$9902.53, together with \$495.12 penalty, and on October 20, 1939, in accordance with the provisions of the applicable statute, sent to the taxpayer by registered mail a notice of said deficiency.

Within ninety (90) days thereafter the taxpayer filed a petition for review from the said notice of deficiency with the United States Board of Tax Appeals, being Docket No. 101189. Said appeal was consolidated for hearing and decision with the appeal of another taxpayer, to-wit, Sherwood Swan, Docket No. 101190, whose appeal was presented simultaneously to the Board. Prior to the trial of said appeal petitioners herein, Minnie L. Whitthorne and Eva Whitthorne, as Executrices of the

Estate of W. R. Whitthorne, [87] deceased, were substituted by order of said Board of Tax Appeals as parties petitioner in the place and stead of W. R. Whitthorne, deceased. Said appeals were tried before said Board of Tax Appeals on oral and documentary evidence and submitted.

On August 13, 1941 the Board of Tax Appeals promulgated its opinion and on the 2nd day of October, 1941, entered its final order and decision in said appeal, wherein and whereby the Board of Tax Appeals ordered and decided that there is a deficiency of \$6,894.28 in income tax and a penalty of \$344.71 against the taxpayer for the said year 1936.

IV.

The following is a brief statement of the nature of the controversy:

The Commissioner contends that taxpayer realized taxable income by reason of the cancellation by Bank of America and Central Bank of Oakland of certain indebtedness owed by taxpayer to said banks. Taxpayer contends that he did not thereby realize any taxable income for the following reasons:

1. The pledged stock which was freed in connection with such cancellation transaction had, six years prior thereto, been by agreement of said banks freed from pursuit for all bank indebtedness except \$200,000.00, which sum of \$200,000.00 was paid to said banks in 1936;

2. Taxpayer contends that cancellation of indebtedness [88] does not result in taxable income

unless, prior to such cancellation transaction, taxpayer was insolvent and after such transaction was solvent, and further, that in determining solvency or insolvency, assets freed from the burden of debt by the cancellation transaction cannot be valued at any amount in excess of their cost basis to taxpayer; applying this rule, taxpayer was insolvent after the cancellation transaction.

3. Taxpayer contends that cancellation of indebtedness does not result in taxable income unless, prior to such cancellation transaction, taxpayer was insolvent and after such transaction was solvent, and further, that in determining solvency or insolvency, assets freed from the burden of debt by the cancellation transaction cannot be valued at any amount in excess of the net fair market value of the assets so released; applying this rule, taxpayer was insolvent after the cancellation transaction.

4. Taxpayer received Class "A" stock and Common stock of Sherwood Swan & Company in a non-taxable exchange and in the year 1936 sold the Class "A" stock. Taxpayer contends that all of the cost basis of such stock should be allocated to the Class "A" stock and none to the Common stock since the latter had no fair market value.

The Commissioner contends that taxpayer is subject to a 5% penalty for a one (1) day delay in filing his Return for the taxable year. Taxpayer contends that he should be relieved from such penalty.

Wherefore, petitioner prays that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit; that a transcript be prepared in accordance with law and with the rules of said Court, and that appropriate action be taken by said Court.

R. W. MACDONALD

Attorney for Petitioner

State of California,
County of Alameda—ss.

R. W. Macdonald, being first duly sworn, deposes and says: That he is the attorney for the petitioner in the above entitled Petition for Review; that he makes this verification for and on behalf of said petitioner; that he has read the foregoing Petition for Review and knows the contents thereof and that the same is true of his own knowledge except as to those matters which are therein stated upon information or belief and as to such matters that he believes the same to be true; that this verification is made by affiant as such attorney for the reason that the facts set forth in said Petition for Review are within the information of affiant.

R. W. MACDONALD

Subscribed and sworn to before me this 22nd day of December, 1941.

(Seal)

A. McCREADY

Notary Public in and for the County of Alameda,
State of California. [90]

In the United States Circuit Court of Appeals
for the Ninth Judicial Circuit

[Title of Cause—Docket No. 101189.]

AFFIDAVIT OF MAILING

Wilma S. Gray, being duly sworn, deposes and says: That she is and at all times herein mentioned was a citizen of the United States, having a business address at 1600 Financial Center Building, Oakland, California, in the County of Alameda, where the mailing herein referred to took place; that she is over the age of eighteen years, not a party to the within entitled cause *of* interested in the event thereof; that on the 23rd day of December, 1941 she enclosed in an envelope a copy of the Petition for Review in the above entitled action, sealed said envelope and addressed the same as follows, to-wit:

“Clerk
Board of Tax Appeals
Washington, D. C.”

That on said day affiant deposited said envelope so addressed and with the postage thereon fully prepaid in the United States Post Office in the City of Oakland, County of Alameda, State of California; that there is and at all times herein mentioned there was regular communication by United States mail between said City of Oakland and said City of Washington, D. C.

WILMA S. GRAY

Subscribed and sworn to before me this 23rd day
of December, 1941.

(Seal)

A. McCREADY

Notary Public in and for the County of Alameda,
State of California.

[Endorsed]: Filed Dec. 26, 1941. [91]

In the United States Circuit Court of Appeals
for the Ninth Judicial Circuit

Docket No. 101190

SHERWOOD SWAN,

Petitioner on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review

PETITION FOR REVIEW

To the Honorable Judges of the United States Cir-
cuit Court of Appeals for the Ninth Judicial
Circuit:

Now comes Sherwood Swan, by R. W. Macdonald,
his attorney, and respectfully shows:

I.

Petitioner, herein referred to as the taxpayer, is
a resident of the City of Oakland, County of Ala-
meda, State of California, Northern District of
California, and his address is S. W. corner Tenth
and Washington Streets, Oakland, California.

Respondent is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States, herein referred to as the Commissioner.

II.

The taxpayer filed an income tax return for the [92] taxable year 1936 with the Collector of Internal Revenue for the District of Northern California, whose office is located within the Ninth Judicial Circuit, wherein the taxpayer also resides.

III.

The Collector determined a deficiency in income tax against the taxpayer for the year 1936 in the amount of \$44,854.91, together with \$2242.74 penalty, and on October 20, 1939, in accordance with the provisions of the applicable statute, sent to the taxpayer by registered mail a notice of said deficiency.

Within ninety (90) days thereafter the taxpayer filed a petition for review from the said notice of deficiency with the United States Board of Tax Appeals, being Docket No. 101190. Said appeal was consolidated for hearing and decision with the appeal of another taxpayer, to-wit, the Estate of W. R. Whitthorne, deceased, Docket No. 101189, whose appeal was presented simultaneously to the Board. Said appeals were tried before said Board of Tax Appeals on oral and documentary evidence and submitted.

On August 13, 1941, the Board of Tax Appeals promulgated its opinion and on the 2nd day of

October, 1941, entered its final order and decision in said appeal, wherein and whereby the Board of Tax Appeals ordered and decided that there is a deficiency of \$38,687.38 in income tax and a penalty of \$1934.37 against the taxpayer for said year 1936. [93]

IV.

The following is a brief statement of the nature of the controversy.

The Commissioner contends that taxpayer realized taxable income by reason of the cancellation by Bank of America and Central Bank of Oakland of certain indebtedness owed by taxpayer to said banks. Taxpayer contends that he did not thereby realize any taxable income for the following reasons:

1. The pledged stock which was freed in connection with such cancellation transaction had, six years prior thereto, been by agreement of said banks freed from pursuit for all bank indebtedness except \$200,000.00, which sum of \$200,000.00 was paid to said banks in 1936;

2. Taxpayer contends that cancellation of indebtedness does not result in taxable income unless, prior to such cancellation transaction, taxpayer was insolvent and after such transaction was solvent, and further, that in determining solvency or insolvency, assets freed from the burden of debt by the cancellation transaction cannot be valued at any amount in excess of their cost basis to taxpayer; applying this rule, taxpayer was insolvent after the cancellation transaction.

3. Taxpayer contends that cancellation of indebtedness does not result in taxable income unless, prior to such cancellation transaction, taxpayer was insolvent and after such transaction was solvent, and further, that in determining [94] solvency or insolvency, assets freed from the burden of debt by the cancellation transaction cannot be valued at any amount in excess of the net fair market value of the assets so released; applying this rule, taxpayer was insolvent after the cancellation transaction.

4. Taxpayer received Class "A" stock and Common stock of Sherwood Swan & Company in a non-taxable exchange and in the year 1936 sold the Class "A" stock. Taxpayer contends that all of the cost basis of such stock should be allocated to the Class "A" stock and none to the Common stock since the latter had no fair market value.

The Commissioner contends that taxpayer is subject to a 5% penalty for a one (1) day delay in filing his Return for the taxable year. Taxpayer contends that he should be relieved from such penalty.

Wherefore, petitioner prays that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit; that a transcript be prepared in accordance with law and with the rules of said Court, and that appropriate action be taken by said Court.

R. W. MACDONALD

Attorney for Petitioner [95]

State of California,
County of Alameda—ss.

R. W. Macdonald, being first duly sworn, deposes and says: That he is the attorney for the petitioner in the above entitled Petition for Review; that he makes this verification for and on behalf of said petitioner; that he has read the foregoing Petition for Review and knows the contents thereof and that the same is true of his own knowledge except as to those matters which are therein stated upon information or belief and as to such matters that he believes the same to be true; that this verification is made by affiant as such attorney for the reason that the facts set forth in said Petition for Review are within the information of affiant.

R. W. MACDONALD

Subscribed and sworn to before me this 22nd day of December, 1941.

(Seal)

A. McCREADY

Notary Public in and for the County of Alameda,
State of California. [96]

In the United States Circuit Court of Appeals
for the Ninth Judicial Circuit

[Title of Cause—Docket No. 101190.]

AFFIDAVIT OF MAILING

Wilma S. Gray, being duly sworn, deposes and says: That she is and at all times herein mentioned

was a citizen of the United States, having a business address at 1600 Financial Center Building, Oakland, California, in the County of Alameda, where the mailing herein referred to took place; that she is over the age of eighteen years, not a party to the within entitled cause or interested in the event thereof; that on the 23rd day of December, 1941 she enclosed in an envelope a copy of the Petition for Review in the above entitled action, sealed said envelope and addressed the same as follows, to-wit:

“Clerk
Board of Tax Appeals
Washington, D. C.”

That on said day affiant deposited said envelope so addressed and with the postage thereon fully prepaid in the United States Post Office in the City of Oakland, County of Alameda, State of California; that there is and at all times herein mentioned there was regular communication by United States mail between said City of Oakland and said City of Washington, D. C.

WILMA S. GRAY

Subscribed and sworn to before me this 23rd day of December, 1941.

(Seal)

A. McCREADY

Notary Public in and for the County of Alameda,
State of California.

[Endorsed]: Filed Dec. 26, 1941. [97]

OFFICIAL REPORT OF PROCEEDINGS [98]

TESTIMONY OF HARRISON S. ROBINSON

Direct Examination

Q. (By Mr. Macdonald) Your name is Harrison S. Robinson? A. Yes.

Q. Your occupation? A. Attorney at law.

Q. And your office is where?

A. Oakland, California.

Q. You were an attorney at law in March of 1930? A. Yes.

Q. Did you at that time have any professional and business relations with Petitioners herein, Sherwood Swan and W. R. Whitthorne? A. Yes.

Q. What professional relations?

A. I was their attorney.

Q. And had been for some years? A. Yes.

Q. And retained for some years thereafter?

A. Yes.

Q. Did you also have business relations with them? A. Yes. [119]

Q. Will you state what those business relations were?

A. They owed me the sum of \$35,000 secured by a pledge of the stock of the Tenth Street Market.

Q. The Tenth Street——

A. (Interposing) That is not the exact name. You will have to refresh my memory on the exact name of the corporation. There were two corporations, and I can't remember which the stock was in.

(Testimony of Harrison S. Robinson.)

Q. The name of the corporation was "Sherwood Swan and Company, Ltd."?

A. That is correct.

Q. Were these gentlemen in March, 1930, also largely indebted to the Bank of America, Oakland Branch, and to Central National Bank of Oakland?

A. They were.

Q. Was an arrangement entered into between Messrs. Whitthorne and Swan and those banks and you in March, 1930, with respect to the refunding of your indebtedness and with respect to the treatment which would be accorded by the bank to the securities of the Sherwood Swan and Company which would be pledged to the banks?

A. May I refer to a memorandum which I prepared from my office records to refresh my memory?

The Member: If your memory is no good without it.

The Witness: Well, I can't say that it is "no good [120] without it."

The Member: Perhaps you had better answer the questions as best you can.

The Witness: Will you read that question, please?

(The question referred to was read by the reporter as above recorded.)

The Witness: There were certain understandings and agreements.

Q. (By Mr. Macdonald) Was that in writing or oral?

A. At the time it was made it was oral, and it is my recollection that letters or a letter was subse-

(Testimony of Harrison S. Robinson.)

quently written by one of the banks expressing the terms of the arrangement, part of them.

Q. Well, we will speak of those letters later, sir. Can you fix the date of that oral agreement?

A. Well, I can only fix the date of it by having a look at my diary kept during that year and entries made day by day, and my inspection of the diary shows that I attended conferences with the banks on—I think it was March 11 and March 12.

Q. 1930? A. Pardon?

Q. 1930?

A. 1930. And it was on one of those two occasions that the final arrangement was expressed and made. [121]

Q. Where were those conferences?

A. At the Board room, the room at which the Board of Directors of the Central Bank of Oakland customarily met at the banking office, in Oakland, California.

Q. Who was present?

A. I remember being present Mr. Joseph Carlston, President of the Central Bank of Oakland——

Q. (Interposing) May I interrupt you, Mr. Robinson? At that time it was the Central National Bank.

A. Central National Bank; thank you.

(Continuing) ——Mr. Oscar L. Cox, who was then Vice-President of the Bank of America and the Senior Officer of that bank in Alameda County, Mr. Swan, — Mr. Sherwood Swan — I think Mr.

(Testimony of Harrison S. Robinson.)

Wainwright,—but of that I haven't a completely independent memory—and myself.

Q. Who was Mr. Wainwright?

A. Mr. Wainwright was a Vice-President of the Central National Bank. And the gentleman who was in the course of these discussions was Mr. Carlston, to my positive recollection.

Q. What was said at this conference?

A. It was stated by the bankers—and by “the bankers” I mean Mr. Carlston and Mr. Cox—that they would by some procedure take over the indebtedness which I held against the stock just heretofore referred to. I was to receive [122] thereby the \$35,000 plus any accrued and unpaid interest up to the time of the consummation of the transaction. Each bank agreed, or stated that they would, if you prefer that, look to the stock which I then held as security for the repayment of \$100,000 each, plus one-half of the \$35,000 plus whatever interest they paid which was then owing to me, and that so far as these two banks were concerned, the stock of the Swan Company would not be looked to by them or resorted to by them for more than \$100,000 each plus one-half of the \$35,000 with interest as aforesaid thereon.

Q. What happened with respect to the agreed payment of \$35,000 and interest to you?

A. That was paid.

Q. When?

A. I couldn't give you the exact date without—it was very shortly after that. There was a sale

(Testimony of Harrison S. Robinson.)

very shortly after that, I think, as soon as the notice could be given for the holding of a pledgee sale.

Q. All I wanted was: That was immediately after this transaction you received your money?

A. Within a comparatively few days.

Q. Do you know whether or not subsequently these banks did release to Mr. Swan the stock in —Mr. Swan and Mr. Whitthorne—the stock in Sherwood and Swan Company which [123] they thus received?

A. What do you mean by “released to them?”

Q. Delivered over to them, freed from pledge.

A. Well, my memory is that that was done in 1936.

Q. Do you know what payment Mr. Swan and Mr. Whitthorne made at that time to secure the release of the stock from pledge?

A. I couldn't tell you, no.

Mr. MacDonald: Cross examine.

Cross Examination

Q. (By Mr. Mather) Mr. Robinson, what was the year in which Sherwood Swan & Whitthorne were indebted to you?

A. Well, they had been indebted to me for many years. That was a loan which had been going on for a long while.

Q. Well, in 1930 were they indebted to you to the extent of \$35,000? A. Principal, yes.

Q. Was that indebtedness secured by Sherwood Swan's stock?

(Testimony of Harrison S. Robinson.)

A. There were two companies and it was secured by the stock of the parent company, as I recollect it.

Q. Yes. And that stock was also up as collateral for loans which Sherwood Swan and Whitthorne owed to the two banks; was it not?

A. I can't remember that independently whether it was or not. [124]

Q. You do not know whether it was?

A. My—I may have known something about it at the time, but I have no present memory of that.

Q. I see. Well, in what year were you paid your \$35,000? A. In 1930.

Q. In 1930? A. Oh, yes.

Q. Yes.

A. But, you see, that \$35,000 had been owing to me for a number of years.

Q. Yes.

A. The exact duration of that loan I could easily ascertain for you.

Q. Well, that is not important. I want to know the year it was satisfied. I was under the impression that shortly after that, that your testimony was they turned the stock over, or that the banks released the stock from pledge?

A. Oh, no; not that I know of.

Mr. Macdonald: He testified that that was in 1936.

The Witness: No, my memory is that the banks held on to their security. In 1930 they paid me off

(Testimony of Harrison S. Robinson.)

the \$35,000, and they were to have as security the stock which we have been talking about for the \$100,000 apiece, and for half of the \$35,000 plus a small amount of interest.

Q. (By Mr. Mather) Now, at that time was the Central [125] Bank of Oakland in receivership?

A. No, sir.

Q. It was after that?

A. Well, it must have been a long while. I can remember distinctly that Mr. Carlston was active and in complete executive charge of the bank.

Q. Of Oakland?

A. The Central Bank of Oakland—the Central National Bank, I should say.

Mr. Mather: I think that is all.

Mr. Macdonald: Thank you.

The Member: Step aside.

(Witness excused.)

Mr. Macdonald: Mr. Wainwright.

JAMES A. WAINWRIGHT

a witness on behalf of Petitioners, was duly sworn and testified as follows:

Direct Examination

Q. (By Mr. Macdonald) Your name, please?

A. James A. Wainwright.

Q. Your occupation, Mr. Wainwright?

(Testimony of James A. Wainwright.)

A. Vice-President, Central Bank.

Q. What was your occupation in March of 1930?

A. I was employed by the Central National Bank handling some of their past due accounts.

[126]

Q. Among such past due accounts were there obligations due from the Petitioners herein, Mr. Sherwood Swan and Mr. W. R. Whitthorne?

A. Yes, sir.

Q. Who had charge of the matter of handling those accounts?

A. Mr. Carlston, President of the Central National Bank, and myself.

Q. Was there an agreement entered into—correction——

Do you of your own knowledge know whether there was any other banking institution to which those gentlemen were similarly indebted?

A. Yes, sir.

Q. What was it? A. Bank of America.

Q. Was there in the month of March, 1930, an agreement entered into between Messrs. Swan and Whitthorne and those two banks with respect to the handling of certain collateral securing their indebtedness to the banks and to the terms under which such collateral was to be released? A. Yes, sir.

Q. Was that agreement oral or in writing?

A. In writing.

Q. By "writing" you mean it was evidenced by

(Testimony of James A. Wainwright.)

certain letters exchanged between officers of the banks? A. That is right. [127]

Q. Prior to those letters was the agreement reached at conference?

A. Numerous conferences, yes.

Q. Where were such conferences held?

A. Some were held in the Central Bank—the Central National Bank in Oakland, and I had several meetings in San Francisco in the offices of the Bank of America with Oscar Cox, the Vice-President of that bank.

Q. Speaking with respect to the meetings held in your bank, can you fix the date with any approximation?

A. I can only fix it by copies of the correspondence which I obtained from the Receiver of the Central National Bank, I believe I gave you copies of those letters which I can identify.

Q. Well, we will take the letters later.

But if you can, fix it to the best of your memory at this time. If you cannot, why, say so, and we will go on.

A. I wouldn't want to fix the date without looking at the correspondence, as it is so long ago.

Q. But the year you can fix?

A. About 1930 I would say.

Q. Who was present at the conferences held in that year in your bank? [128]

A. Well, there was numerous conferences. I remember distinctly conferences with Mr. Sherwood

(Testimony of James A. Wainwright.)

Swan and Mr. Carlston and Mr. Oscar Cox, that is, in the Central National Bank in Oakland. In the Bank of America in San Francisco I was the only representing the Central National Bank.

Q. Well, I am speaking with reference to the conference held in your bank. You mentioned Mr. Swan, Mr. Cox, Mr. Carlston and yourself. Was Mr. Harrison Robinson also there?

A. I have a recollection that I was at that meeting that I heard Mr. Robinson testify to. I wouldn't want to say definitely.

Q. What is your memory of what was said at that meeting?

Mr. Mather: If your Honor please, I will object to that, the witness having testified that this agreement was reduced to writing by letters, writing what the agreement was.

I submit that that would be the best evidence, if there was such writing.

The Member: Is there any virtue in the oral recollection?

Mr. Macdonald: In this, sir: I think these writings, which were days, and sometimes months afterwards, were simply reminders to the various parties that they had on March 12, 1930, or whenever it was, entered into an agreement. I doubt if these papers constitute an agreement. [129] But it is Mr. Robinson writing to Mr. Swan, Mr. Cox writing to Mr. Wainwright saying, "We did so agree."

The Member: I will overrule the objection.

(Testimony of James A. Wainwright.)

The Witness: We had numerous conferences and it was agreed between the Bank of America, Central National Bank and Mr. Swan that we would release the stock, the Central National Bank had as security and the Bank of America would agree to release the stock they had as security, that is, the stock of the Sherwood Swan Company, I believe it was, the holding company, on the payment of \$100,000 to each bank. And we agreed that we would not pursue that stock or the market that was being operated by Sherwood Swan and Company of anything being in excess of \$100,000 for each bank.

Mr. Macdonald: I have submitted, your Honor, to Mr. Mather and now desire to introduce in evidence marked exhibit next in order, a copy of a letter dated March 14, 1930, addressed to Mr. J. F. Carlston, President, Central National Bank, signed by Oscar L. Cox, Vice-President, Bank of America.

That will be Petitioner's No. 1?

The Member: It will be received.

Mr. Mather: No objection.

The Clerk: Exhibit 1. [130]

(The letter so offered and received was marked Petitioner's Exhibit No. 1 and made a part of this record.)

Mr. MacDonald: Copy of a letter dated March 15, 1930, signed by J. F. Carlston, President, Central National Bank, addressed to Mr. Oscar Cox, Vice-President, Bank of America, in reply to Exhibit No. 1.

(Testimony of James A. Wainwright.)

Cross Examination

Q. (By Mr. Mather) At the time, Mr. Wainwright, that these conferences were taking place in 1930, were Mr. Swan and Mr. Whitthorne indebted to your bank and the other bank in excess of \$100,000? A. Yes, sir.

Q. I show you Petitioner's Exhibit 1 and ask you if that is your recollection of the agreement that was entered into in 1930 with respect to this indebtedness?

A. (Examining document) Yes, that is my understanding.

Q. I show you Petitioner's Exhibit 2 and ask you if it is your understanding that there was no intention on the part of the banks to release Sherwood Swan and Whitthorne for any indebtedness that they owed the banks in 1930?

A. Do you mean indebtedness in excess of \$100,000; if that had been paid?

Mr. Mather: No. Will you read the question?

(The question referred to was read by the reporter as above recorded.) [133]

The Witness: There was no intention to forgive any of the indebtedness.

The Member: What was that?

The Witness: No intention to forgive any of the indebtedness.

Q. (By Mr. Mather) And your bank from 1930 on until 1936 made repeated demands upon Sher-

(Testimony of James A. Wainwright.)

wood Swan and Whitthorne for payment of their indebtedness to your bank, did they not?

A. Well, all I could testify is from 1930 to 1933 because the Central National Bank was in receivership in March, 1933. And thereafter the affairs of the Central National Bank were handled by, first, a conservator and then a receiver.

Q. Until 1933 did you make any demands upon them for the payment of their indebtedness?

A. I am quite sure that we made the ordinary demands we make on every debtor by way of notices, when the notes would come due, and so on.

The Member: Am I to understand that they did make demands upon these debtors?

The Witness: I would say "Yes."

The Member: All right.

Q. (By Mr. Mather) Were there conferences between your bank and the Bank of America relative to the foreclosure of the properties of Sherwood Swan and Whitthorne? [134]

A. Foreclosure of properties?

Q. Yes.

A. I didn't know there was any property other than the securities we are talking of here.

The Member: Well, now, read the question.

(The question referred to was read by the reporter as above recorded.)

The Witness: I don't recall that we discussed foreclosure.

(Testimony of James A. Wainwright.)

Q. (By Mr. Mather) Were there discussions with respect to instituting suit for the payment of the indebtedness?

A. I don't believe it was ever discussed. I don't recall the discussion of suit. I do recall numerous discussions urging Mr. Swan to endeavor to finance the market in order to pay on our indebtedness.

Mr. Mather: That is all.

Mr. MacDonald: That is all, Mr. Wainwright.

The Member: Let me ask you one question:

These loans which were outstanding, how did they originate? These indebtednesses, I mean; how did they originate?

The Witness: Your Honor, I couldn't say as to the origin because they were—as I recall it, the entire debt was due when I came with the bank, and I presume it was the ordinary advances made to Sherwood Swan—— [135]

The Member: (Interposing) You don't know?

The Witness: I don't know. I couldn't say.

The Member: All you know is that from 1930 on there were indebtednesses in these amounts?

The Witness: That is right.

The Member: By these individuals to the banks; is that right?

The Witness: That is right.

The Member: Very well.

Mr. MacDonald: Just one question, Mr. Wainwright.

(Testimony of James A. Wainwright.)

Redirect Examination

Q. (By Mr. MacDonald) On cross examination you testified that there was no intent in the 1930 agreement to release indebtedness, but there was an agreement to release security upon agreed terms?

A. That is right.

Mr. MacDonald: That is all.

(Witness excused.)

Mr. MacDonald: If your Honor please, Mr. Oscar L. Cox, whose name has been used herein, who at that time was a Vice-President of the Bank of America here, is now the President of the Union Trust Company of Cleveland, Ohio.

May it be stipulated that if Mr. Cox were here, he would testify to the same effect that Mr. Wainwright has?

Mr. Mather: No. But it may be stipulated that he [136] would testify to the substance of the letters he wrote.

Now, that was my understanding, as I recall, with you; that I would stipulate if Mr. Cox were called as a witness, he would testify to the same information that is contained in his letters.

The Member: Which are what exhibits?

Mr. MacDonald: There are two or three letters from him here, sir.

Mr. Mather: It might save stipulation with respect to each one of his letters, if that is agreeable.

Mr. MacDonald: Well, Mr. Mather, I do not want to push your stipulation if you did not understand it as I did at our conference. But I wanted Mr. Cox' testimony stipulated with respect to the oral agreement of March 1930; that that agreement was entered into in the office of Central Bank between the parties.

Mr. Mather: Well, I will stipulate that his understanding with respect to the oral agreement is as set forth in his letter of such and such a date which is Exhibit, Petitioner's Exhibit—(Pause).

Mr. MacDonald: All right. I am satisfied with that statement.

The Member: Now, identify the exhibits, please.

Mr. MacDonald: 1, 3, 5, 6 and 7, all signed by Mr. Cox. [137]

SHERWOOD SWAN

a witness on behalf of the Petitioners, was sworn and testified as follows:

Direct Examination

Q. (By Mr. MacDonald) Your name is Sherwood Swan? A. Yes. [138]

Q. You are one of the Petitioners herein?

(Testimony of Sherwood Swan.)

A. Yes, sir.

Q. You are one of the officers of Sherwood Swan & Company, Ltd.?

A. Yes.

Q. The President?

A. Yes.

Q. And have been such since its inception?

A. Yes.

Q. When?

A. 1924 the Corporation was organized.

Q. You have been acquainted with Mr. Whitthorne until the date of his death from what date?

A. 1909, in the fall.

Q. During the interval, you were engaged in business associations of various kinds with him?

A. Right.

Q. In March of 1930 you and Mr. Whitthorne were each heavily indebted to the Central National Bank of Oakland and to the Bank of America?

A. Yes, sir.

Q. Those were in amounts far in excess of \$100,000 each to each of the banks?

A. Yes.

Q. Those loans at that time—— [139]

The Member: (Interposing) Mr. MacDonald, I want to be sure about this word "each".

There are two debtors, and apparently several creditors. I am not sure what the word "each" means as it has been used here several times.

Mr. MacDonald: Thank you, sir. I think that would clarify matters.

Q. (By Mr. MacDonald) Can you from memory

(Testimony of Sherwood Swan.)

give an itemization of your indebtedness to each of those banks?

If not, I can supply it after the recess. The reason I hesitate, sir, is I know I have it buried in my files. Some of the notes were joint notes signed by each gentleman, some of it secured by the assets of one and some of it the other.

The Member: I am only interested to avoid having the record contain any ambiguity.

Mr. MacDonald: Yes, I didn't realize this is ambiguous until you called my attention to it.

Mr. Mather: Mr. MacDonald, is there any dispute with respect to the indebtedness of each of these petitioners, as set forth in the deficiency letter from which the appeal was taken?

Mr. MacDonald: The deficiency letter is a correct statement of the indebtedness of the respective petitioners to the respective banks.

The Member: Well, is that agreed? [140]

Mr. Mather: Yes, your Honor.

The Member: Very well.

Mr. MacDonald: Thank you for that.

Mr. Mather: That is stipulated.

Q. (By Mr. MacDonald) Prior to the agreement of March, 1930, your indebtedness and Mr. Whitthorne's to those banks was secured by what securities?

A. At the Bank of America there was stock of Hale Bros. Realty Company owned by me.

(Testimony of Sherwood Swan.)

Q. 2071 shares?

A. Right. Offhand that is the only security that I recall prior to that—prior to the March, 1930, agreement.

Q. Well, then, may I remind you there was also pledged to the Bank of America stocks of Swan's and of Wasserman-Gattman Company; is that correct, sir?

A. That was not prior to the agreement of March. They all came along approximately at the same time, Mr. MacDonald.

Q. Thank you. Prior to March, 1930, were you and Mr. Whitthorne in debt to Mr. Harrison Robinson?

A. To the extent of \$35,000 and some accrued interest.

Q. Evidenced by—(pause)

A. A joint and several note, as I recall.

Q. And secured by—(pause)

A. A thousand shares of the capital stock of Sherwood Swan and Company, Ltd., which was all of the capital stock of [141] Sherwood Swan and Company, Ltd.

Q. That stock was at that time owned—(pause)

A. Jointly by Whitthorne and myself.

Q. Mr. Swan, I remind you that the word "jointly" has a legal meaning.

What do you mean by the use of the word "jointly"?

(Testimony of Sherwood Swan.)

A. My recollection was that it hadn't been divided, but our ownership was half and half.

Q. Was there an agreement entered into in March, 1930, between you and Mr. Whitthorne, Mr. Robinson and those two banks with respect to the refinancing of Mr. Robinson's loan and with respect to the handling by the banks of the stock of Sherwood Swan and Company, to be pledged to the banks? A. There was.

Q. When was that agreement entered into?

A. Well, approximately around the middle of March. The exact date isn't in my mind.

The Member: May I interrupt long enough to clear up something that I have been in doubt about since the beginning of the trial?

Mr. MacDonald: Yes, sir.

The Member: Prior to 1930 I understand that you were indebted in one amount, namely, \$35,000, to Robinson, and that you were also indebted in a separate amount to one or more of the banks; is that correct? [142]

The Witness: That is correct, your Honor.

The Member: And to Robinson was pledged the 1000 outstanding shares of the Sherwood Swan company?

The Witness: "And Company, Ltd.," your Honor. That is correct.

The Member: Yes. And that was the entire outstanding stock of that corporation?

(Testimony of Sherwood Swan.)

The Witness: That is correct.

The Member: So that to the bank creditors there was not at that time any pledge of the shares of Sherwood Swan and Company, Ltd.?

The Witness: That is correct.

The Member: Is that correct?

The Witness: That is correct, your Honor.

Mr. MacDonald: Interrupting my examination of the witness for a moment, sir, and to proceed along that line, and, as suggested by Mr. Mather, I am reading from the Agent's deficiency letter herein:

"The indebtedness to the Bank of America was a \$65,000 indebtedness of Mr. Swan alone and \$89,066.33 indebtedness signed by both Whitthorne and Swan, a total liability of \$154,066.33, apportioned by the Agent, \$109,533.16 from Swan and \$44,533.17 from Whitthorne and indebtedness to the Central National Bank of from Swan alone \$20,000, Whitthorne and Swan together \$165,081.32, a total [143] indebtedness to that bank of \$185,081.32, apportioned \$102,540.66 to Swan, \$82,540.66 to Whitthorne."

The Member: Is that agreed, Mr. Mather?

Mr. Mather: That is agreed, your Honor.

The Member: My question of this witness was only inspired by the fact that the witness, Robinson, left it in a fog as to the pledge. He said that there were securities pledged to the bank and to him, and I could not tell which securities he was

(Testimony of Sherwood Swan.)

referring to and how that pledge operated at the time in 1930.

Proceed.

Mr. MacDonald: My last question?

(The question referred to was read by the reporter as above recorded.)

Q. (By Mr. MacDonald) Was it orally or in writing? A. That was an oral agreement.

Q. Where was it entered into?

A. In the Directors' room of the Central National Bank.

Q. Who was present?

A. There was Mr. Carlston, Mr. Cox, Mr. Robinson, Mr. Wainwright and myself.

Q. What was said?

A. Discussion was had in regard to the matter of the banks coming into possession of the entire 1000 shares of the capital stock of Sherwood Swan and Company by the banks [144] paying Mr. Robinson the amount of his indebtedness, plus the accrued interest then unpaid.

The Member: You do not mean the amount of his indebtedness; do you?

The Witness: No, the amount of our indebtedness, Whitthorne's and mine, the indebtedness of \$35,000 plus the interest then unpaid; this \$35,000 plus the unpaid interest due Robinson, being repaid subsequently by ourselves plus the sum of \$100,000 to each of the two banks, the stock would be released to us beyond pursuit.

(Testimony of Sherwood Swan.)

The Member: What stock would be released to you?

The Witness: The stock of Sherwood Swan and Company, Ltd., your Honor.

Q. (By Mr. MacDonald) 1000 shares?

A. 1000 shares.

Q. One-half held in pledge by each bank?

A. Yes, sir.

Q. Was that stock ever released to you?

A. Yes.

Q. From pledge?

A. That stock was released from pledge in December of 1936 to the Trust Department of the Anglo Bank, and subsequently in the recasting of the stock of Sherwood Swan and Company we came into possession of the unsold balance in the recasted corporation, recasted capital of the same corpora- [145] tion.

Q. What payment did you cause to be made to the Bank of America at the time of such release of stock from its pledge?

A. \$100,000 to the Bank of America.

Q. What payment did you cause to be made to the receiver of the Central National Bank at the time of such release of its 500 shares of pledged stock?

A. \$75,000 in cash and a joint and several note, Whitthorne and myself, of \$25,000.

Q. A total of—(pause)

(Testimony of Sherwood Swan.)

A. \$175,000 to the two banks, of cash, and the \$20,000 note.

Q. I hand you your petition herein and, calling attention to page 4, paragraph Roman numeral five, Arabic one, and ask you whether the six items set forth therein represented all your assets in March, 1930?

A. (Examining document) Yes, sir.

Q. I call your attention to the same paragraph and ask you whether the seven items of liabilities set forth therein, ending on the top of the next page, represented your personal and joint and several liabilities at that time?

A. (Examining document) Yes, sir.

Q. Were you at this time familiar—by “this time” I mean March, 1930—with Mr. Whitthorne’s business affairs and with his assets and liabilities?

[146]

A. I feel that I was.

Q. I hand you herewith Mr. Whitthorne’s petition herein, calling your attention to page 4, paragraph V, Roman, Arabic 1 thereof, and ask you whether or not the items I to V thereof represented all of Mr. Whitthorne’s assets on that date?

A. (Examining document) I believe that to be a correct statement of Mr. Whitthorne’s assets as of that date.

Q. I call your attention to the same paragraph the four items marked ((i)) to ((iv)), of liabilities, and ask you whether those represented all of

(Testimony of Sherwood Swan.)

Mr. Whitthorne's liabilities, joint and personal and joint and several upon that date?

A. I believe it a correct statement of the liabilities of Mr. Whitthorne's as of that date.

The Member: We will take a five-minute recess.

(Whereupon, a brief recess was taken after which proceedings were resumed as follows:)

Q. (By Mr. MacDonald) Mr. Swan, you had just identified and testified to the truthfulness of a statement of your assets and your liabilities in March, 1930, Mr. Whitthorne's assets and his liabilities in 1930 as shown by the paragraphs in your respective pleadings setting forth such assets and liabilities.

That statement in the pleading of liabilities shows [147] the securities pledged for each respective liability. My question before was not broad enough to cover the securities and I am now asking you:

Were those statements a correct statement of the securities pledged to each of the banks for the respective liabilities? A. They were.

Q. I hand you a description of real property and ask you if that is a correct description of the real property of Sherwood Swan and Company in December, 1936?

A. (Examining document) No, there is an error in this description, Mr. MacDonald.

Q. Thank you, sir. Will you make the correction?

A. Yes, sir. In the fifth line from the bottom

(Testimony of Sherwood Swan.)

“... thence easterly parallel with said line of Tenth Street, one hundred . . . feet to said Westerly line of Washington Street . . .”

That should be one hundred fifty feet.

That is 100, 175—(pause)

Q. Your correction is proper.

A. Let me see. That is correct. That makes 300 feet.

Mr. MacDonald: I would ask that this be marked exhibit next in order. I want to show it to your expert witnesses who testify as to the value of the property.

The Member: You are offering it? [148]

Mr. MacDonald: Yes, sir.

The Member: Any objection?

Mr. Mather: No objection.

The Clerk: Exhibit 9.

(The said property description so offered and received in evidence was marked Petitioner's Exhibit No. 9 and is made a part of this record.)

Mr. MacDonald: If your Honor please, I would ask permission to temporarily withdraw this witness for this reason:

I have present in the courtroom two real estate men who will testify as to values. Mr. Swan will be here all the rest of the day for testimony, and I do not want to hold them beyond the noon hour, if I can avoid it.

(Testimony of Sherwood Swan.)

Mr. Mather says he has no objection to my withdrawing Mr. Swan for this purpose.

The Member: Very well.

(Witness temporarily excused.)

Mr. MacDonald: Mr. Kittrelle.

R. W. KITTRELLE

a witness called on behalf of Petitioners, was duly sworn and testified as follows:

Direct Examination

Q. (By Mr. MacDonald) Your name?

A. R. W. Kittrelle. [149]

The Clerk: What was that?

The Witness: R. W. Kittrelle, K-i-t-t-r-e-l-l-e.

Q. (By Mr. MacDonald) And your place of business, Mr. Kittrelle? A. Oakland.

Q. And your profession?

A. I am a real estate broker, appraiser.

Q. How long have you been engaged in that business? A. Since 1906.

Q. Have you made a specialty of the appraising branch of that business? A. Yes, sir.

Q. For what institutions, if any, are you now engaged as appraiser?

A. Well, I am the appraiser of the Central Bank of Oakland, First Federal Savings, the Alameda County Federal Savings, San Francisco Fed-

(Testimony of R. W. Kittrelle.)

eral Savings, Connecticut Mutual Life Insurance Company, Alameda Investment, and do a general appraisal business besides.

Q. What court experience have you had in the appraisal field?

A. Well, I have appeared both for private parties and for the State, City, County and the schools in condemnation proceedings.

Q. In what county? [150]

A. Alameda County.

Q. That is the county that Oakland is situated in?

A. Yes, sir.

The Member: Is this market in Oakland?

Mr. MacDonald: Yes, sir.

The Witness: Tenth and Washington.

The Member: Oh, I thought it was in San Francisco.

Mr. MacDonald: I wish we had made that more clear in the start. I am sorry.

Q. (By Mr. MacDonald) I hand you Petitioner's Exhibit No. 9, which is a description of the real property of Sherwood Swan & Company as of December, 1936, and ask you if you were in December, 1936, familiar with that property?

A. (Examining document) Yes, sir.

Q. Did you then in December, 1936, know the fair market value of that real estate?

A. I consider that I did. I made an appraisal on it, Mr. MacDonald in November—on November 25, '36.

(Testimony of R. W. Kittrelle.)

Q. For whom?

A. For the Central Bank on the land and improvements at that time.

Q. What, in your opinion, was the fair market value of that land, exclusive of improvements, on December 16, 1936?

Mr. Mather: That is objected to as calling for a conclusion of the witness. [151]

The Member: The objection is overruled.

The Witness: My estimate of value was \$195,000 for the land.

Mr. Macdonald: Cross examine.

Cross Examination

Q. (By Mr. Mather) Do you know what improvements were on the property in 1936?

A. Yes, sir.

Q. What did the improvements consist of?

A. A market. There was—oh, the exact date of the change of a piece on Washington I am not positive because I am talking from memory—but a market covered practically all of the property.

Mr. Mather: That is all.

Mr. Macdonald: That is all.

The Member: Tell me what was the occasion of your appraisal in November, 1936

The Witness: Mr. Swan came to the bank for a loan, I think. They did not discuss that with me, except that I know he was trying to refinance, and

(Testimony of R. W. Kittrelle.)

two or three times I was called in and discussed it.

If my memory is correct, I believe Mr. Swan went out to a life insurance company at the time, and I believe those people also communicated with me.

The Member: That is all. [152]

(Witness excused.)

Mr. Macdonald: Mr. Field.

EDWARD B. FIELD

a witness on behalf of Petitioners, was duly sworn and testified as follows:

Direct Examination

Q. (By Mr. Macdonald) Your name?

A. Edward B. Field, F-i-e-l-d.

Q. And your place of business?

A. 369 15th Street, Oakland.

Q. And your occupation?

A. Real Estate Broker and appraiser.

Q. How long have you been so engaged?

A. Twenty years.

Q. All of that time in the city of Oakland?

A. Yes, sir.

Q. Can you state to the Court what experience you have had in the matter of appraisals?

A. Over 20 years I have appraised for the State of California, the County of Alameda, the City of

(Testimony of Edward B. Field.)

Oakland, innumerable corporations, individuals, loan companies.

Q. Have you had court experience in that field?

A. Many, many times; yes, sir.

Q. One or two recent illustrations?

A. I was appointed by the Superior Court of Alameda County [153] two weeks ago in the condemnation by the Housing Authority in West Oakland, the property condemned by the Housing Authority and so-called slum clearance in West Oakland.

Q. Were you in 1936 familiar with the real estate—December, 1936—then owned by Sherwood Swan and Company, Ltd., sometimes known as the “Tenth Street Market,” situate at the corner of Tenth and Washington Streets? A. Yes, sir.

Q. I hand you Petitioner’s Exhibit No. 9, stated to be a description of that property.

Were you in December, 1936, familiar with the fair market value of that land, not including improvements? A. Yes, sir.

Q. What, in your opinion, was such fair market value as of December 16, 1936?

Mr. Mather: That is objected to as calling for a conclusion of the witness, no proper foundation having been laid for the introduction of this testimony.

The Member: Overruled.

The Witness: May I finish the description?

Mr. Macdonald: Yes.

(Testimony of Edward B. Field.)

The Member: The question, as I understand it, is limited to the land.

Mr. Macdonald: Yes, sir.

The Witness: Yes, sir. [154]

Q. (By Mr. Macdonald) What was such fair market value? A. \$200,000.

Mr. Macdonald: Cross examine.

Cross Examination

Q. (By Mr. Mather) Are you familiar with the improvements on the property at that time?

A. Yes, sir.

Mr. Mather: That is all.

(Witness excused.)

Mr. Macdonald: Mr. Swan.

SHERWOOD SWAN

a witness on behalf of Petitioners, previously duly sworn, testified further as follows:

Direct Examination

(Resumed)

Q. (By Mr. Macdonald) In your testimony with respect to the steps taken on December 16, 1936, to release from pledge the stock in Sherwood Swan and Company, you stated that you paid to the Receiver for the Central National Bank \$75,000 cash and a \$20,000 note? A. That is correct.

Q. That note was signed by Messrs. Whitthorne and Swan? A. Yes.

(Testimony of Sherwood Swan.)

Q. What interest did it bear?

A. No interest.

Q. How was it payable? [155]

A. It was payable \$4,000 per year for a period of five years.

Q. Have payments been made to date?

A. Three \$4,000 payments have been made.

Q. By whom? A. By myself.

Q. Those annual payments were due on what date?

A. I think in each case, December 16th, the anniversary of the making of the notes.

Mr. Macdonald: What is the next number?

The Clerk: Ten.

Q. (By Mr. Macdonald) Will you state to the Court the reclassification of the stock of Sherwood Swan and Company, Limited, which took place on December 16, 1936?

A. It was—the 1000 common shares of Sherwood Swan and Company, Ltd., was recast into 30,000 shares of class A stock and 45,000 shares of common stock.

Q. A portion of such class A preferred stock was marked by you and Mr. Whitthorne to a broker?

A. Yes, sir.

Q. On what date?

A. December—my recollection of the date of the contract was December 16, 1936.

Q. How many shares?

A. 25,000 shares was the amount actually sold.

(Testimony of Sherwood Swan.)

I haven't [156] refreshed my mind recently as to the amount that was contracted to be sold.

Q. I hand you a statement of assets and liabilities, and ask if that is a correct statement of your assets and liabilities as of December, 1936, immediately prior to the marketing of such a preferred stock? [157]

A. I would say that it is a correct statement of my assets and liabilities as of that time.

Mr. Macdonald: I ask that this be Petitioner's Exhibit 10.

Mr. Mather: Objected to as not the best evidence.

The Member: Overruled.

The Clerk: Exhibit 10.

(The said financial statement so offered and received in evidence was marked Petitioners' Exhibit No. 10 and is made a part of this record.)

Q. (By Mr. Macdonald) I hand you a statement reading "W. R. Whitthorne statement of assets and liabilities as at December 16, 1930."

You have previously testified to your years of association with Mr. Whitthorne. Were you familiar with his assets and liabilities as of December 16, 1930?

A. I believe I was familiar with his—— [158]

Q. (Interposing) '36.

A. (Continuing) ——assets and liabilities.

(Testimony of Sherwood Swan.)

I was going to make that correction, Mr. Macdonald. This statement is as of December 16, 1936. I feel that I am familiar with his affairs as of that date.

Q. Is that statement a true statement of his assets and liabilities as of that date?

Mr. Mather: That is objected to as calling for a conclusion of the witness, not the best evidence.

The Member: I will sustain that objection until it appears how the statement was made, who made it, how it was ascertained. Otherwise, the witness may testify from his recollection without refreshing it.

Mr. Macdonald: Well, let's try that. Let's take this away from you, sir (obtaining document from the witness).

Q. (By Mr. Macdonald) What investments, if any, did W. R. Witthorne have on December 16, 1936?

A. He had a half interest in Sherwood Swan and Company, Ltd.

Q. How many shares was that?

A. In the original corporation he had 500 shares and in the recast—that is, 500 shares of common. In the recast corporation he had 22500 shares of common and 2500 shares of A. [159]

Q. Your 2500 shares of A is spoke of as after the sale to the public of a portion of the A?

A. That is correct.

(Testimony of Sherwood Swan.)

Q. How many shares of A did he have prior to the sale to the public?

A. The 30,000 shares of A was divided, half Whitthorne and half myself. That would mean 15,000 shares of A for Mr. Whitthorne and 22,500 shares of common for Mr. Whitthorne.

Q. What other assets did Mr. Whitthorne have at that date? A. He had nothing else.

Q. What were his liabilities as of that date?

A. He had a half interest of the liability on this \$20,000 note given to the Central *company*; he had one-half of the liability due the Trust department of the Anglo, \$2,500. He had half of the——

The Member: (Interposing) Half of the \$2,500?

The Witness: No, half of five thousand, your Honor, in the sum of \$2,500. He had half of the indebtedness due *Roberts*, his half being \$250; owed half of the indebtedness in addition to the \$5,000 due the Trust Department, the \$175,000 that we borrowed on a joint and several note, and for which all of the original stock of Sherwood Swan and Company and the recast stock of Sherwood Swan and Company was collateral.

Q. That was owing to what bank? [160]

A. The Anglo.

Q. Did he owe any attorneys' fees, to your knowledge?

A. He owed one-half of the attorneys' fees to Orrick, Dahlquist, Palmer—I forget the other.

(Testimony of Sherwood Swan.)

Q. Orrick, Palmer & Dahlquist.

A. His share was \$1,000.

Q. Were those all of his liabilities?

A. As nearly as I can recall them at this time without refreshing my memory.

The Member: Are you quite sure, however, that you have stated all of his assets?

The Witness: Yes, sir.

The Member: But there may possibly have been other liabilities?

The Witness: There might possibly have been; might possibly have been others. His affairs and mine were so intertwined, your Honor, that at that particular time it was virtually that his were the same as mine.

Q. (By Mr. Macdonald) Were there any sales in the year 1936 of the common stock of Sherwood Swan and Company, Ltd., the old stock, prior to the recasting thereof? A. No, there were not.

Q. Was there ever any sale after the recasting of the stock of the B or common stock of Sherwood Swan and Company, Ltd. [161]

A. There was one transaction between Whitthorne and myself.

Q. What was that transaction and when?

A. I don't recall the exact date, Mr. Macdonald?

Q. What year?

A. My recollection is it was in 1936. The number of shares was 4,500.

Q. 4,500 shares of the common stock, class B common stock of Sherwood Swan and Company, Ltd., and that was sold by whom to whom?

(Testimony of Sherwood Swan.)

A. That was sold by Mr. Whitthorne to me.

Q. What consideration did you pay him for that stock?

A. One—one—Mr. Whitthorne and I had that joint and several note with the Central, and I agreed to pay——

Q. (Interposing) To him notes, to leave it that way.

The note that you refer to was the \$20,000 non-interest-bearing note which you and Mr. Whitthorne on December 16, 1936, signed to the receiver of the Central National Bank; is that correct?

A. That is correct. And I assumed—and I agreed to assume Mr. Whitthorne's half of that in consideration of his transferring to me this 4,500 shares of the common stock.

Q. How did you reach that figure as the appropriate consideration for these 500 shares? [162]

A. It is just one of these things that happens between old friends.

Q. How many shares was it?

A. 4,500 shares. I say it is just one of these things that happen between old friends.

Mr. Whitthorne was a man of rather mature years.

The Member: Well, do you mean he was older than you?

The Witness: Oh, yes; much older.

The Member: You look rather mature yourself.

(Testimony of Sherwood Swan.)

Mr. Macdonald: I think we are all mature, Mr. Swan; I hope.

Q. (By Mr. Macdonald) How old was Mr. Whitthorne?

A. Mr. Whitthorne passed away this year at the age of 77. I just passed 53, so the difference between our ages was 24 years. We had been associated, as I have just explained, for many years, and because of his senior—very senior years and just one of those nice things that friends work out between themselves, we discussed the matter back and forth, and it was agreed that I would assume the other half of this \$20,000 note, joint and several note.

Q. All the payments that have been made on that note have been made by you personally?

A. That is correct.

The Member: Now, specifically there. Am I to [163] understand that that means that you agreed to the liability of \$10,000, or, to relieve him of the liability of \$10,000 on the \$20,000 note and he was to transfer to you 4,500 shares of the class B common stock; is that right?

The Witness: That is correct, your Honor.

The Member: Now, did you have any negotiation which brought about the fixing of the 4,500 shares, or the consideration?

The Witness: No, we never—we never discussed value as such.

The Member: You did not dicker about this?

(Testimony of Sherwood Swan.)

The Witness: Oh, we talked about it for some little time, but we never went back to the books and discussed value, sir. I wanted the 4,500 shares of stock in order to give me what would be substantial control of the company, and Mr. Whitthorne wanted me to have it because of the fact that in the ordinary course of things I would remain much longer than he, and we just agreed on the assumption of this liability more as—because it was that figure than that that was the value of it. We didn't discuss value. We never thought of it that way.

The Member: Well, I can understand about the \$10,000 of the note, from what you say. But I am trying to find a reason for 4,500 shares, rather than some other figure. [164]

The Witness: Oh, I can explain that very simply.

That gave me 60 per cent holding and gave him 40 per cent holding.

The Member: Without the 4,500 shares, what were your respective proportions?

The Witness: Fifty-fifty.

Q. (By Mr. Macdonald) Have there ever been any other sales of that class B stock? A. No.

Q. Any offers or bids? A. No.

Q. Have you ever offered it for sale?

A. No.

Q. Or had Mr. Whitthorne or his estate?

A. Not—Mr. Whitthorne never did during his lifetime, that he ever informed me in regard to, and I know nothing about it subsequently, except that

(Testimony of Sherwood Swan.)

I have acted as adviser to the family, and they have never mentioned it.

Q. Has any bid ever been received from anyone else offering to buy any of that B stock?

A. Not so far as I know.

The Member: When did Whitthorne die? It is not in the record.

The Witness: July 25th of this year.

The Member: Oh, just a few months ago? [165]

Mr. Macdonald: Your Honor, it has been indicated that the settlement with the Central National Bank was made through the Receiver of that bank, which had been appointed in 1933 and was acting in 1936. [166]

I have obtained from the Receiver—which Mr. Mather has examined—copies of Receiver's petition to the Federal Court asking for leave to make this settlement, and a copy of the Federal Court's order authorizing settlement.

I ask that be received as exhibit next in order.

Mr. Mather: No objection.

The Clerk: Do you want these one exhibit?

Mr. Macdonald: No, two.

The Clerk: The petition will be Exhibit 13 and the order Exhibit 14.

(The said petition so offered and received in evidence was marked Petitioner's Exhibit No. 13 and is made a part of this record.)

(The said order so offered and received in evidence was marked Petitioner's Exhibit No. 14 and is made a part of this record.)

(Testimony of Sherwood Swan.)

Mr. Macdonald: That was the Central Bank's mechanism of closing. The Bank of America adopted as its mechanism for closing a pledgee sale which was conducted on behalf of the Bank of America on December 16, 1936, by Mr. Matt Wahrhaftig, who was the attorney for the Bank of America in Oakland at that time.

He has signed his certificate of pledgee sale of the proceedings whereby he sold securities at pledgee's sale. [167]

I offer this as Petitioner's next in order.

Mr. Mather: No objection.

The Clerk: Exhibit 15.

(The said certificate so offered and received in evidence was marked Petitioner's Exhibit No. 15 and is made a part of this record.) [168]

Q. Now, Petitioner's Exhibit 10, Mr. Swan, is a statement of assets and liabilities of yourself.

Who is R. L. Underhill?

A. R. L. Underhill is an appraiser, calls himself an "appraisal engineer", lives on Tamalpais Way in Berkeley.

Q. And under the heading of "liabilities" is \$200.00.

What does that represent?

A. That is the unpaid balance on a bill rendered by Mr. Underhill to myself. The original amount of the bill was \$700.00.

Q. What was it for?

(Testimony of Sherwood Swan.)

A. It has to do with an appraisal made by Mr. Underhill, I judge along in 1934. I don't recall the exact date.

Q. For what purpose? [169]

A. Appraisal of the market—the property known as the “Tenth Street Market property.”

Q. Do you know what he appraised it at?

Mr. Macdonald: Just a minute. I object to that as hearsay.

The Member: Well, the job was done for this witness. I will overrule the objection.

The question is: “Do you know what he appraised it at?”

The Witness: Not the exact figure. I would be glad to state a general recollection.

Q. (By Mr. Mather) All right, what is your general recollection?

Mr. Macdonald: May I renew the objection and make this point, sir:

If **Mr. Underhill** were here, I would have an opportunity to cross examine. For his appraisal to be introduced in any direct manner like this would prevent me from breaking it down, if I could, by cross examination.

The Member: I will overrule the objection.

Mr. Macdonald: Exception.

The Witness: My general recollection is around \$600,000.

Q. (By Mr. Mather) Now, you spoke, Mr. Swan, of “Recasting this stock.”

(Testimony of Sherwood Swan.)

What do you mean by "recast"? [170]

A. I am not a technical man, but I will explain to you what I mean.

The original stock of the corporation, Sherwood Swan and Company, Ltd., was for 1000 shares of \$100 each par value, \$100,000 total.

After what I have referred to as the "recasting" there was 30,000 shares of A stock of a par value of \$10, and 45,000 shares of common stock of no par value.

Q. What became of the thousand shares that had been outstanding prior to this time?

A. That was turned in to the corporation.

Q. And cancelled? A. Yes, sir.

Q. So that the entire capital stock as the result of this transaction consisted of two classes of stock, 30,000 class A and 45,000 common?

A. That is correct.

Q. Now at the time of this transaction, or, recasting, as you call it, was there a prospectus issued by the brokers in connection with the sale of that 25,000 shares to the public? A. There was.

Mr. Mather: May I have this marked for identification?

The Clerk: Respondent's A marked for identification. [171]

(The prospectus referred to was thereupon marked Respondent's Exhibit A for identification.)

(Testimony of Sherwood Swan.)

Q. (By Mr. Mather) I hand you, Mr. Swan, a document marked for identification "Respondent's Exhibit A" and ask you to state, if you can, what that is?

A. (Examining document) That is the prospectus that was issued at the time this stock was offered to the public.

Q. That was along in the latter part of 1936?

A. That is correct.

Q. Is that your signature (indicating)?

A. Yes, sir.

Q. Is the information contained therein true, to the best of your information?

A. It is true to the best of my information at that time, sir.

Q. Yes. Now, referring to this prospectus, and particularly to the paragraph relative to your properties, I am wondering if you can refresh your recollection from that and tell me what value Mr. Underhill placed on these properties?

A. As of the date of this appraisal, which is a second appraisal of the property, the one that we discussed—the one you asked me about a moment ago—was a different appraisal. This appraisal made as of December 14, 1936, is for the sum of \$710—

[172]

Mr. Macdonald: (Interposing) Just a minute. I object to the evidence of appraisal coming in in this indirect way as hearsay; and any way except

(Testimony of Sherwood Swan.)

by the testimony of the appraiser present in court subject to cross examination.

The Member: Overruled.

Mr. Macdonald: Exception.

The Witness: \$710,000, Mr. Mather.

Q. (By Mr. Mather) Was Mr. Underhill employed by you to make an appraisal of the property for the purpose of this prospectus?

A. As President of the corporation I employed Mr. Underhill to make this appraisal.

Mr. Mather: Yes. Mark this for identification Respondent's Exhibit B.

The Clerk: Marked for identification "Respondent's Exhibit B".

(The income tax return referred to was thereupon marked Respondent's Exhibit No. B for identification.)

Q. (By Mr. Mather) I hand you a document, Mr. Swan, marked for identification "Respondent's Exhibit B" and ask you to state, if you can, what that document is?

A. (Examining document) This is my personal income tax statement for the calendar year 1936.

Q. Did you give that document some consideration at the [173] time it was prepared?

A. Oh, yes.

Q. Was it prepared from the best available information you had at the time that it was prepared?

A. I would say "yes."

(Testimony of Sherwood Swan.)

Q. Did you believe, Mr. Swan, at the time you prepared that return that the correct proportionment between the class A stock of Sherwood Swan and the common stock was 61.67 for the class A and 38.33 for the common?

A. (Examining document) These statements were prepared in consultation between our accountants and our attorneys at that time, and it was our opinion that that was a fair division.

I personally had no opinion in regard to it. It was one of those things that was discussed back and forth, and I acquiesced in the discussions.

Q. Sherwood Swan and Company had been paying substantial dividends; had it not?

A. Yes, sir.

Q. And continued to pay after '36; did it not?

A. Yes.

Q. Substantial dividends? A. Yes, sir.

The Member: We will suspend until 2:00 o'clock.

(Whereupon, at 12:30 p. m. a recess was taken until [174] 2:00 o'clock p. m. of the same day.)

[175]

(Testimony of Sherwood Swan.)

by the testimony of the appraiser present in court subject to cross examination.

The Member: Overruled.

Mr. Macdonald: Exception.

The Witness: \$710,000, Mr. Mather.

Q. (By Mr. Mather) Was Mr. Underhill employed by you to make an appraisal of the property for the purpose of this prospectus?

A. As President of the corporation I employed Mr. Underhill to make this appraisal.

Mr. Mather: Yes. Mark this for identification Respondent's Exhibit B.

The Clerk: Marked for identification "Respondent's Exhibit B".

(The income tax return referred to was thereupon marked Respondent's Exhibit No. B for identification.)

Q. (By Mr. Mather) I hand you a document, Mr. Swan, marked for identification "Respondent's Exhibit B" and ask you to state, if you can, what that document is?

A. (Examining document) This is my personal income tax statement for the calendar year 1936.

Q. Did you give that document some consideration at the [173] time it was prepared?

A. Oh, yes.

Q. Was it prepared from the best available information you had at the time that it was prepared?

A. I would say "yes."

(Testimony of Sherwood Swan.)

Q. Did you believe, Mr. Swan, at the time you prepared that return that the correct proportionment between the class A stock of Sherwood Swan and the common stock was 61.67 for the class A and 38.33 for the common?

A. (Examining document) These statements were prepared in consultation between our accountants and our attorneys at that time, and it was our opinion that that was a fair division.

I personally had no opinion in regard to it. It was one of those things that was discussed back and forth, and I acquiesced in the discussions.

Q. Sherwood Swan and Company had been paying substantial dividends; had it not?

A. Yes, sir.

Q. And continued to pay after '36; did it not?

A. Yes.

Q. Substantial dividends? A. Yes, sir.

The Member: We will suspend until 2:00 o'clock.

(Whereupon, at 12:30 p. m. a recess was taken until [174] 2:00 o'clock p. m. of the same day.)

[175]

(Testimony of Sherwood Swan.)

Afternoon Session

2:00 o'clock p.m.

SHERWOOD SWAN

a witness on behalf of the petitioner, previously duly sworn, testified further as follows:

Cross Examination

(Resumed)

Q. (By Mr. Mather) Mr. Swan, Respondent's Exhibit A for identification correctly sets forth the dividends that were paid by Sherwood Swan and Company from 1930 on; does it not?

A. Through 1936.

Q. Yes. A. Yes, sir.

Q. And it also correctly sets forth the earnings of the Company for the same period?

A. Yes, sir.

Q. Was that Respondent's Exhibit A prepared for use in connection with the marketing of the 25,000 class A shares of the company?

A. This particular form set-up was so prepared, but some of these previous statements were the audited statements already made prior to the preparation of this form.

Q. Was that document made available to the public in connection with marketing the 25,000 class A shares? A. This document? [176]

Q. Yes. A. Yes, sir.

(Testimony of Sherwood Swan.)

Q. And the 25,000 class A shares were sold to the public, were they not, for \$10 a share?

A. Plus accrued dividends, yes, sir.

Mr. MacDonald: Just a moment. If you know, of your own knowledge. Did you sell them?

The Witness: No. That was provided for in the agreement.

Mr. Mather: Will you read the question, please?

(The question referred to was read by the reporter as above recorded.)

Mr. MacDonald: I object to the question as indefinite, as not indicating who sold them to the public, whether by this taxpayers or some one else.

The Member: Sustained.

Q. (By Mr. Mather) Do you know whether the 25,000 shares were sold to the public at \$10 a share?

A. Not of my own knowledge, no, sir.

Q. You do know that the 25,000 shares were sold within a period of approximately 90 days; do you not, Mr. Swan?

A. I would say so, to the best of my knowledge and belief.

Q. You do know that the 25,000 shares were sold to the public, do you not? [177]

A. I would say "yes."

Q. Now, did Mr. Whitthorne own his own home, Mr. Swan? A. No.

Q. He rented that?

A. No. When the home was purchased originally

(Testimony of Sherwood Swan.)

it was purchased in Mrs. Whitthorne's name. It still is not clear.

The Member: You mean the title is in doubt?

The Witness: No. It is not fully paid for, your Honor.

The Member: Oh. That is what you mean by "clear", is it, clear from encumbrances?

The Witness: Yes, sir.

The Member: I see.

Q. (By Mr. Mather) Who was paying for it?

A. Who is paying for it now?

Q. Who was during 1936?

A. At that particular time Mr. Whitthorne was not living in the home. It was rented, and my knowledge of Mr. Whitthorne's affairs doesn't include who paid for it. Mr. Whitthorne had an income at that time of \$35 a week.

Q. You do not know who was paying for the home?

A. At that time, no, I do not.

Q. Was there not, Mr. Swan, always another note for \$10,000 upon which you and Mr. Whitthorne were jointly obligated, which was assumed by you in addition to the \$20,000 note that you testified to? [178]

A. No, not that I know of.

Q. I hand you, Mr. Swan, a document and ask you to state, if you can, what that is?

A. (Examining document) This is the agreement to run between Miller and Company or Rob-

(Testimony of Sherwood Swan.)

ert N. Miller and Company and Whitthorne and myself for the purchase by Miller and Company of 25,000 shares of the A stock of Sherwood Swan and Company, Ltd.

Q. There is an exhibit, I believe, attached to that document which refers to \$25,000 collateral which was put up by you and Mr. Whitthorne to secure the carrying out of the agreement.

Was that money put up by you and Mr. Whitthorne?

A. It was borrowed by Mr. Whitthorne and me and put up by Mr. Whitthorne and me.

Q. To whom?

A. Mr. Whitthorne and me.

Q. Who was it put up with; the bank?

A. That was put up with the Anglo.

Q. The Anglo California National Bank.

A. Yes, sir.

Q. Now, was that money, \$25,000, to be returned to you when the \$175,000 note was returned?

A. Yes, sir.

Q. And was it so returned to you by the bank?

A. Yes, sir. [179]

Q. I show you——

The Member: (Interposing) Now, before you get away from that paper that he has now, do you not at least want it marked?

Mr. Mather: Well, I suspect that the Petitioner will probably want to put that in.

The Member: Whatever it is, the testimony of

(Testimony of Sherwood Swan.)

the witness should in the transcript be related to a paper which is in the record and designated as something.

Mr. MacDonald: I certainly want it in evidence, and if it will help Mr. Mather, it may be introduced as Petitioner's next in order right now.

Mr. Mather: No objection.

The Member: Very well.

The Clerk: Exhibit 16.

(The said agreement so offered and received in evidence was marked Petitioner's Exhibit No. 16 and is made a part of this record.)

Q. (By Mr. Mather) I hand you Petitioner's Exhibit 10, Mr. Swan.

Do you know who prepared that exhibit?

A. (Examining document) No, I don't know who prepared it.

Q. Do you know from what information it was prepared?

A. It was prepared from information that has been accumulated from time to time over the period of the last several years. [180]

Q. Is the information contained in your books of account?

A. The last part of that question I didn't catch.

The Member: Read it.

(The question referred to was read by the reporter as above recorded.)

(Testimony of Sherwood Swan.)

The Witness: "Books of account"? I am sorry, but I don't keep personal books of account.

Q. (By Mr. Mather) Well, do you know from what information that document, Petitioner's Exhibit No. 10, was prepared?

A. A series of original documents and personal notes.

Q. Now, included in the liability side of that exhibit, Mr. Swan, is there any obligation with respect to the \$25,000 which you and Mr. Whitthorne borrowed to put up as collateral with the bank?

A. No, sir, there is not.

Q. What does the item to Harry Camp represent?

A. This \$7,500 due Harry Camp is an accumulation of items plus accumulated interest that had been advanced at one time and another from, I should judge, starting along in 1930 and continuing along through the summer of 1936.

Q. Was it a note?

A. There was no note given at that time. It was just an accumulation of items.

Q. What record did you have with respect to that item? [181]

A. Well, just memorandums, and I subsequently checked the memorandum of those items in the office of Harry Camp and verified this figure as an approximate figure.

Mr. Mather: That is all.

(Testimony of Sherwood Swan.)

Redirect Examination

Q. (By Mr. MacDonald) Mr. Swan, Mr. Mather on cross examination was querying with respect to another possible note other than the \$20,000 note to the Central Bank with respect to which you and Mr. Whitthorne might be liable as of December, 1936.

I ask you whether in the settlement of an old obligation with Mr. David Wasserman, of Sacramento, Mr. Whitthorne was liable on any of the obligation continued after 1930?

A. None whatever.

Q. I show you a copy of a letter from Mr. Whitthorne and yourself to Mr. Wasserman and a copy of a note dated December 1, 1930, for \$5,000, signed by you in favor of Mr. Wasserman, and ask you if those are true copies?

A. (Examining documents) To the best of my knowledge and belief, those are.

Mr. MacDonald: I ask that that be marked Petitioner's next in order to be given a single number.

Mr. Mather: No objection.

The Clerk: No. 17. [182]

(The said letter so offered and received in evidence was marked Petitioner's Exhibit No. 17, and is made a part of this record.)

Q. (By Mr. MacDonald) Mr. Swan, the bank officials and Mr. Robinson testified that the banks

(Testimony of Sherwood Swan.)

paid off Mr. Robinson the \$35,000 and accrued interest which was owing from you to him.

Were the banks shortly after that time reimbursed for that \$35,000 and interest so paid by them? A. They were.

Q. How long after December, 1936, did Sherwood Swan and Company, Ltd., continue to pay dividends on its common stock?

A. Two years.

Mr. MacDonald: That is all.

Mr. Mather: If your Honor please, just one question I inadvertently overlooked.

Recross Examination

Q. (By Mr. Mather) I hand you, Mr. Swan, Petitioner's Exhibit No. 16, and ask you if that agreement was carried out in accordance with its terms?

A. I haven't read this agreement probably for more than four years.

I have some recollection that—having to do with some stock in addition to the 25,000 shares that Gersten & Company actually took; that there was an option or something [183] like that having to do with a portion, at least, of the balance, to-wit, 5000 shares, the difference between 25,000 shares and 30,000 shares of the A which wasn't in reality carried out.

With that exception, so far as I know this contract was carried out.

(Testimony of Sherwood Swan.)

Q. In 1937 did you have 2500 shares of class A stock standing in your name on the books of the corporation? A. Yes, sir.

Q. Did Mr. Whitthorne? A. Yes, sir.

Q. Do you still have that class A in your name?

A. Yes, sir.

Q. It has never been sold?

A. That is correct.

Q. The only stock that was sold was the 25,000 class A that we have been discussing here?

A. That is correct.

Q. Your explanation has to do with the balance of the class A, the 5000 which stand in the name of you and Mr. Whitthorne?

A. That is correct. [184]

FRANK G. SHORT

a witness called on behalf of the Petitioners, was duly sworn and testified as follows: [191]

Direct Examination

Q. (By Mr. MacDonald) Your name, sir.

A. Frank G. Short.

Q. And your occupation?

A. I am a Certified Public Accountant.

Q. How long have you been one?

A. Oh, I have been certified in this state for about eight years. I have been qualified as an ac-

(Testimony of Frank G. Short.)

countant for over 20. I am also a chartered accountant of Canada.

Q. Are you one of that group of accountants which are described as "Tax experts"?

A. I am not.

Q. What branch of the profession do you specialize in?

A. I am a general practitioner. I am fairly familiar with the—with practice before the Securities and Exchange Commission, but not otherwise.

Q. I hand you herewith Respondent's Exhibit B for identification, the filed income tax return of Mr. Swan for the year 1936, and I ask you if you know who prepared that?

A. (Examining document) I did.

Q. I forgot to ask this preliminary question, Mr. Short: With what firm are you associated?

A. I am the resident partner of Barrow, Wade, Guthrie & Company in this city. [192]

Q. Well, how did it happen that you prepared that return *rather one* of the men in your office who are specialists in tax matters?

A. Already in the course of the transactions, which have been the subject of evidence while I have been here, I had a close personal knowledge of them as they went along. Consequently many of the facts involved in this return were already known to me.

Q. There is attached to that return a somewhat

(Testimony of Frank G. Short.)

lengthy statement, twelve pages, as I recall it, setting forth the history of these transactions?

A. Yes.

Q. Did you prepare that?

A. I dictated it, yes.

Q. How does it happen that the return was prepared in that somewhat unusual form, rather than simply the filling in of blanks?

A. Well, as I mentioned before, I am not a tax expert. I don't know the answers to some of the points involved.

The transactions were very complicated, and I thought the best result, both for the client and the Government, would be obtained by giving a rather full memorandum of all the facts as I knew them. Then it appeared to me that even if I hadn't arrived at the right conclusion, that there was ample disclosure so that the matter could be ironed out [193] later.

Q. There is in that memorandum, Mr. Short, a purported allocation of cost between the A and B stocks.

Will you find that?

A. (Examining document) It is some time since I did this. I am sorry.

Yes, I have it.

Q. Did you prepare that? A. Yes.

Q. What was the basis of that allocation?

A. It was partly based on the equity in the book assets at December 31, 1936, and partly based upon

(Testimony of Frank G. Short.)

an allocation of the equity in the average earnings up to that point.

Q. It was in part, then, based on the book figures for the assets? A. That is right.

Mr. Mather: Now, if your Honor please, the witness, I think, should be permitted to testify. I object to that question.

Mr. MacDonald: All right, withdraw it.

Q. (By Mr. MacDonald) If you had known that the actual value, the fair market value of the assets was different from the book value, would you have used that same basis of apportionment?

Mr. Mather: That is objected to as irrelevant and [194] immaterial and not the proper subject of expert testimony.

The Member: Sustained. Was this witness tendered as an expert?

Mr. MacDonald: No, sir.

The Member: I sustain the objection, nevertheless. But I want to be sure that I understand.

Mr. MacDonald: I started to ask him, not to show that he was an expert, but my only purpose was to show that the allocation was based on book value and not on actual value of the assets.

Q. (By Mr. MacDonald) Since preparing that return have you acquired knowledge as to the fair market value of the assets of Sherwood Swan and Company, Ltd., as of December, 1936?

Mr. Mather: That is objected to as irrelevant and immaterial.

(Testimony of Frank G. Short.)

The Member: Sustained.

Q. (By Mr. MacDonald) In preparing that allocation, did you take into consideration the fair market value of the assets of Sherwood Swan and Company as of December, 1936?

Mr. Mather: That is objected to as irrelevant and immaterial.

The Member: Overruled.

The Witness: Will you please define the fair market value before I answer the question, please?

[195]

Q. (By Mr. Macdonald) The fair market value is that value which is reached by a willing buyer and a willing seller in the market for the asset in question.

A. The answer to that question, then, is "No".

Q. In your opinion, was there any fair market value in December, 1936, for the Class B stock?

Mr. Mather: That is objected to as calling for a conclusion of the witness.

The Member: Sustained.

Q. (By Mr. Macdonald) Mr. Short, was there some question asked Mr. Swan as to whether or not all of the A stock which was marketed by Messrs. Whitthorne and Swan to Miller and Company was resold by Miller and Company to the public?

Have you any knowledge as to that?

A. Yes.

Q. What is your knowledge?

(Testimony of Frank G. Short.)

A. It was not all sold to the public, using the term "sale" in its ordinary sense. I know——

Q. (Interposing) I don't hear you.

A. It was not all sold to the public, using the term "sale" in its ordinary sense.

I know of at least one block, 1200 shares, I believe, which was used by them to settle a debt.

The Member: By whom?

The Witness: By Miller and Company, later Gersten & [196] Company.

The Member: To settle a debt?

The Witness: Yes. The shareholder concerned lives in Santa Barbara. I don't know his name.

Q. (By Mr. Macdonald) You have testified that you prepared that return.

Over what period of time were you engaged in its preparation, Mr. Short?

A. (Examining document) I commenced to give it some consideration at some date which I can't now remember, early in 1937. I commenced active work on it on March 18, 1937, and finished on May 29, 1937.

Q. How was it it took that length of time to prepare?

A. Well, there were a great many occasions when I was lacking in information, and I had to put my difficulty up to Mr. Swan to supply the information, and that involved delay while he was getting it. I was busy on it fairly continuously during that period but with substantial gaps between work.

(Testimony of Frank G. Short.)

Q. On what date did you say the return was finally completed? A. May 29, 1937.

Q. What day of the week was that?

A. Saturday.

Q. What was the next business day? [197]

A. The next business day was the following Tuesday, Monday being a holiday, Decoration Day.

Q. Tuesday, June 1? A. Tuesday, June 1.

Q. What did you do with the returns on that day?

A. They were delivered to Mr. Swan at our office.

The Member: On June 1.

The Witness: On June 1.

Q. (By Mr. Macdonald) What returns do you mean when you say "they"?

A. There were four returns involved, Messrs. Swan and Whitthorne and their wives.

Q. What knowledge, if any, have you with respect to the notarying of the returns?

A. My signature was authenticated by our Notary on June 1 on all four returns. Mrs. Swan's was also authenticated by our notary. The other three returns at that time were unsigned.

Q. On what date was Mrs. Swan's notaried?

A. The same date as mine, that is, June 1.

Q. Under what circumstances did you deliver the returns to Mr. Swan on June 1?

A. Well, he came to the office to get them. I had a short conversation with him. He took them away to get them signed and filed. [198]

(Testimony of Frank G. Short.)

The Member: I may have misunderstood you. Did you say that the Notary took Mrs. Swan's signature on the same day as yours?

The Witness: Yes.

The Member: Or Mr. Swan's?

The Witness: Mrs.

Mr. Macdonald: The wife, yes, sir.

The Witness: Yes.

The Member: But you delivered the returns all to Mr. Swan on that day?

The Witness: Right, including Mrs. Swan's.

Q. (By Mr. Macdonald) Have you any recollection as to the hour of the day?

A. I believe it was the morning.

Q. What is your knowledge with respect to the matter of extensions for the filing of these returns?

A. On March 15th I obtained without difficulty one month's extension, as I remember it. Possibly it is attached.

On April 15th, in spite of a good deal of work, I was nowhere near finished, and I applied, I believe, for a two-month extension and was granted a month and a half. That particular extension had a big rubber stamp, "Final Extension" on it, as I recall it.

The Member: Well, is that the way it was expressed, [199] a month and a half?

The Witness: No. It was to a particular day, which was June 1st.

Mr. Macdonald: Cross examine.

(Testimony of Frank G. Short.)

Cross Examination

Q. (By Mr. Mather) Mr. Short, where did you obtain your information with respect to the block of 1200 shares of stock that you testified to?

A. I mentioned earlier that I was to some extent in the middle of these transactions at the time they had taken place, and I was consulted not merely by Mr. Swan but by Mr. Gersten at the same time. I had some knowledge of their affairs and their difficulties, too.

Q. Now, was my question clear?

A. You asked under what circumstances?

Q. No. I asked where you obtained your information.

A. Oh, I see. I obtained it from Mr. Gersten.

Q. Mr. Gersten told you about it?

A. Yes.

Q. Now, I show you, Mr. Short, Respondent's Exhibit A for identification and ask you if that document was certified to by your firm?

A. (Examining document) It was. That is my signature.

Mr. Mather: No further cross examination.

Mr. Macdonald: Just one moment. (Examining document) [200]

That is all, Mr. Short.

(Witness excused.)

Mr. Macdonald: Mr. Foley.

U. R. FOLEY

a witness called on behalf of Petitioners, was duly sworn and testified as follows:

Direct Examination

Q. (By Mr. Macdonald) Your name is——

A. U. R. Foley.

Q. And your occupation?

A. I am the controller at Sherwood Swan and Company.

Q. How long have you occupied that position?

A. I have been with the firm since 1925.

Q. And have been Controller for what period?

A. I have been Controller for the past five years.

Q. As part of your duty as Controller, do you keep the books of the Company?

A. Yes, sir.

[201]

The Member: Let me ask the witness: Is that balance sheet entirely a book balance sheet, or is it adjusted to actual or fair market or other value, other than what the books show?

The Witness: It is taken directly from the books.

The Member: That balance sheet, then, is a correct transcript of the results of the books; is it?

The Witness: Yes, your Honor.

The Clerk: Exhibit 18.

(The said audit report so offered and received in evidence was marked Petitioner's Exhibit No. 18, and is made a part of this record.)

The Member: And that is as of what date?

[203]

Mr. Macdonald: December 31, 1936. [204]

FRANK G. SHORT

a witness on behalf of Petitioners, having been previously duly sworn, testified further as follows:

Direct Examination

Q. (By Mr. Macdonald) Mr. Short, you have in your hands Petitioner's Exhibit 18. Did you prepare that?

A. It was prepared partly by myself and partly by assistants working under my supervision.

Q. Then you are familiar with it and know what it is you have before you and what you are talking about?

A. I am. I personally signed the report in front of me.

Q. The Court was endeavoring to relate this to the statement attached to Respondent's Exhibit A for identification. That is the prospectus.

Mr. Foley, the previous witness, testified that the one in Exhibit A was a consolidated one. Is that correct?

A. Is this—— (pause)

Q. No, this (indicating).

A. That is a consolidated one.

Q. What is your testimony with respect to whether [210] Petitioner's Exhibit 18 is consolidated or not?

A. Well, this volume includes two balance sheets. The one Mr. Foley was looking at rather intently is an unconsolidated balance sheet.

A little later on in the volume you will find the consolidated balance sheet, and it is the second one that is comparable to that.

(Testimony of Frank G. Short.)

The Member: Now, you point out the second one which you say is comparable to the prospectus consolidated balance sheet.

Q. (By Mr. Macdonald) Give the page number and read the heading into the record.

A. These have no page numbers, I am sorry to say.

This is entitled "For filing with the Securities and Exchange Commission" and was done in accordance with their regulations.

The Member: Have you got it before you now?

The Witness. Yes. I can read its title.

The Member: Let that be marked, Mr. Clerk, as Exhibit No. 19, which although it is a part of No. 18, identifies it as the one the witness is talking about.

Mr. Macdonald: That will be helpful.

The Member: Will you read it to the clerk?

The Witness: May I read the caption into the record? [211]

The Member: Well, that is not important, as long as it is identified. The mark is best.

The Clerk: Mark it for identification 19.

The Member: Not "for identification". This is an exhibit that is in evidence, and it is No. 19.

(The said sheet contained in Petitioner's Exhibit 18, so offered and received in evidence, was marked Petitioner's Exhibit No. 19 and is made a part of this record.)

(Testimony of Frank G. Short.)

The Member: So that 19, Mr. Witness, and A, except for the difference in dates, cover the same ground; is that right?

The Witness: They do, except that there was a statutory merger of one of the subsidiaries with the parent during the intervening period, but the business remained unchanged. All of the affairs of the parent company were still in both statements.

The Member: The balance sheet of three companies of October 31, 1936, became the balance sheet of two companies on December 31, 1936; is that right?

The Witness: Yes, but without any basic change in the character of the business.

The Member: All right. Now, who has got the witness?

Mr. Macdonald: Mr. Mather.

Mr. Mather: No cross examination. [212]

Mr. Macdonald: That is all, Mr. Short.

(Witness excused.)

Mr. Macdonald: Mr. Swan.

The Member: Were you through with the witness Foley?

Mr. Macdonald: Yes, sir.

The Member: Are you through, Mr. Mather?

Mr. Mather: Yes, sir.

Mr. Macdonald: Mr. Swan.

SHERWOOD SWAN

a witness recalled on behalf of Petitioner, having previously been duly sworn, testified further as follows:

Direct Examination (Continued)

The Member: You are going into the reasonableness now?

Mr. Macdonald: That is all.

The Member: Has it been made clear in the record either by my own questions or somebody else's as to what I asked of earlier witnesses, as to what was the origin of the indebtedness of Whitthorne and Swan to the bank?

If that hasn't been clear, or there is any doubt about it, I wish you would clear it up.

Mr. Macdonald: The only doubt I have is what you mean by "origin".

We read into the record the list of indebtedness to [213] the bank, and we stipulated that was correct.

The Member: That is not what I want. Perhaps I can ask the witness myself.

At the time that you were indebted to Robinson for \$35,000, and also to the banks—that is, as I recall, it goes back to 1930—will you state what the indebtedness to the banks was for, how it arose, that is, as to whether you borrowed the money or what you did?

The Witness: In the winter of 1927 Mr. Whitthorne and I borrowed \$100,000 from the Bank of America—it might have been the Bank of Italy

(Testimony of Sherwood Swan.)

at that time—but it was the bank that became the Bank of America, in the event that there was a difference in name, as a part payment on the purchase of a corporation in Sacramento, a store called “Wasserman-Gattman Co.”

In the spring of 1928 Mr. Whitthorne and I borrowed from the Central National Bank in Oakland—I don’t recall the exact amounts that we borrowed at the time—but there were original borrowings and then there were additional borrowings to purchase a business in Oakland called “Upwrights” which we changed the name of to “Swan’s, Inc.”

Swan’s, Inc. lost money, and about a year after the spring of 1928, which would be in the spring of 1929, we borrowed additional funds from the Central Bank, and we merged the Wasserman-Gattman Corporation and Swan’s, Inc., [214] and ran the Sacramento and the Oakland stores as one corporation.

At various times before the public we operated under the name of “Swan” and subsequently when a sub-tenant of ours got into financial difficulties we ran it before the public, for the purpose of capitalizing whatever the good will of the tenant’s name was, under the name of Swan and Gerwin, but the corporate entity at that time was Wasserman-Gattman Co.

The Member: So that these indebtednesses to the banks were what was left of the actual cash borrowed to create them?

(Testimony of Sherwood Swan.)

The Witness: That is correct, to put it in these mercantile businesses which——

The Member: (Interposing) But so far as the banks were concerned, you got money from the banks and you owed them, had to repay it?

The Witness: That is correct.

The Member: And that continued to be so down through 1930, and from then on, until 1936?

The Witness: That is correct.

The Member: And the \$35,000 which you owed to——

The Witness: (Interposing) Robinson.

The Member: (Continuing)——Robinson, how did that originate? Was that by a borrowing of money?

The Witness: Yes. We borrowed—Whitthorne and I [215] borrowed some money which we loaned to Sherwood Swan and Company to buy a piece of property which is at present, and was as of 1930, a part of the Tenth Street Market property.

The Member: That is all I wanted to know.

Mr. Macdonald: That is helpful, sir. Thank you.

Q. (By Mr. Macdonald) Now, Mr. Swan, directing your testimony to the matter of the filing of these four returns, Mrs. Whitthorne's, Mr. Whitthorne's, and Mrs. Swan's and yours, Mr. Short has testified that he completed the returns on Saturday, May 29, 1937, and delivered them to you on Tuesday, June 1, 1937, Mr. Short having obtained and notaried the signature of Mrs. Swan, the other ones unsigned.

(Testimony of Sherwood Swan.)

Will you carry on the story from there on, to the best of your memory, with respect to what was done with those returns?

A. Well, my recollection is that as of the same date, June 1, that our signatures, to-wit, Whitthorne's and Mrs. Whitthorne's and my own were notaried by Wallace Knox in Oakland.

I have our corporation's check which I was fortunate enough to find in our files.

Mr. Macdonald: Let me show it to Mr. Mather before you testify, please. (Obtaining document from witness.) [216]

Q. (By Mr. Macdonald) You have produced a check dated June 1, 1937, drawn by Sherwood Swan and Company, Ltd., to the Collector of Internal Revenue for the sum of \$423.64.

Can you state in payment of what that check was drawn?

A. Well, inasmuch as this was June 1, my recollection is that Mr. Short told me that we would be obliged to pay one-half of the tax for the year for which this check was issued, which is Mrs. Swan's income tax for the year 1936.

Mr. Macdonald: I would like to offer in evidence as Petitioner's next in order this check.

Mr. Mather: I have no objection.

The Clerk: Exhibit 20.

(The said check so offered and received in evidence was marked Petitioner's Exhibit No. 20 and is made a part of this record.)

(Testimony of Sherwood Swan.)

Q. (By Mr. Macdonald) The signatures to that check are whose?

A. Mr. Foley, U. R. Foley's and my own.

Q. And the remaining writing on that check is whose?

A. This is one of the clerks in the office (indicating).

Q. You can identify her by the handwriting?

A. I discussed the matter in the office, and while I don't know the name of the Clerk, my understanding from discussing the matter in the office that it was our relief clerk who ordinarily draws checks after the other regular clerk has [217] gone home.

Q. At what time of day?

A. The regular clerk who draws the checks leaves at a quarter of five because she comes in early in the morning; goes home early.

Q. After you had these four returns then notarized, Mrs. Swan's in San Francisco, the other three you have testified by Mr. Knox in Oakland, and this check, what further did you do?

A. Well, my general recollection is that those statements were taken to the Internal Revenue Department and an attempt made to file them.

Q. Where?

A. In the Post Office Building in Oakland; an attempt made to file them.

This is recollection, and it is—I admit it is just a little bit hazy in my mind. But after digging up the check, after digging up the notarial record, my

(Testimony of Sherwood Swan.)

impression is that I attempted to file them, and being unable to file them they were slipped through the slot in the door in the office. I personally have a definite objection to filing statements of that kind by mail. I have no recollection of having filed a personal statement by mail.

I have a more or less series of recollections of always having filed statements, personal income tax statements [218] in person. And upon one of these occasions I put it through the slot in the door, and my feeling is that it could have been—this particular time—although from the point of view of my saying that I am absolutely positive that this was the occasion, I am sorry I cannot do that.

Mr. Macdonald: We do not want you to testify to something you cannot remember.

Cross examine.

Cross Examination

Q. (By Mr. Mather) Mr. Swan, I do not know that I am entirely clear with respect to the \$35,000 transaction.

Now, is it your testimony that that \$35,000 obligation was paid by you and Mr. Whitthorne in 1930?

A. A dividend was declared from the funds of Sherwood Swan and Company in 1930, and my recollection is that the stock—now, this is in terms of its being actually whether the checks were drawn to Whitthorne and me, or whether the checks were drawn to the banks in whose name it stood sooner or

(Testimony of Sherwood Swan.)

later with—whether they were originally drawn in the bank's name, or whether they were drawn in Whitthorne's and my name, depending on how that stock was issued, when it was released from Mr. Robinson over to the banks, I don't recall. But in any event, a dividend was declared for such a sum of money as would repay the loan were sent and paid to the banks. [219]

Q. Paid to the banks? A. Yes, sir.

Q. And the banks then paid Robinson?

A. That is correct, sir.

Q. At that time was——

Mr. Macdonald: (Interposing) May I interrupt just a second? Because neither of us wants to get the record confused.

You say the banks then paid Robinson?

Mr. Mather: Yes.

Mr. Macdonald: If you will forgive me for stating the fact from counsel table, the banks paid Robinson first and were reimbursed by this means.

Q. (By Mr. Mather) Well, Mr. Swan, was this thousand shares of Sherwood Swan up as collateral for the \$35,000 obligation to Robinson?

A. Yes, sir.

Q. Was it also up as collateral for loans to the bank? A. No, sir.

Q. All right. Was the \$35,000 obligation to Robinson paid by you prior to the time the stock was put up as collateral to the bank?

A. No, sir. It was done subsequently.

(Testimony of Sherwood Swan.)

Q. Well——

A. (Interposing) With corporation funds paid out in a [220] dividend.

Q. Yes. But do I understand that the obligation to Robinson was paid off prior to the stock being placed as collateral with the bank?

A. Now, the actual machinery of that, I haven't looked into it from that point of view ever. It is ten years ago. In order to know specifically whether Robinson was paid off first before it went to the banks or whether it was paid—whether Robinson was paid off via the dividend route, my mind isn't entirely clear on that.

If you will permit me, I will recite as nearly as I can exactly what took place.

Q. That is what I would like to have you do, Mr. Swan.

A. We had been indebted for many years to Mr. Robinson, and I stated to the Court a moment ago how the debt originated.

After the Wasserman-Gattman Company got into trouble and these series of discussions took place, to which Mr. Robinson and Mr. Wainwright testified this morning, arrangements were made for the banks to reimburse Mr. Robinson and take over the stock, the thousand shares of Sherwood Swan and Company stock.

Now, there was a notice filed so that it would have appeared to take the form of a sale, of a pub-

(Testimony of Sherwood Swan.)

lic sale; the motions were gone through before the world; made that appear [221] as a matter of form. The stock was duly delivered to the respective banks, 500 to each bank—500 shares to each bank.

Now, just when Mr. Robinson was paid I can't tell you, excepting that in due time a dividend for the amount of \$35,000, or a series of dividends for \$35,000, plus the accumulated interest, was paid to the banks and the banks paid Mr. Robinson.

Now, whether they paid him before the dividend was declared or after the dividend was declared, it is not clear in my mind. I have never gone back and looked up the details of it, and it is ten years ago.

Q. In any event, it was right along in '30 or '31?

A. My recollection is that it was in 1930.

Mr. Mather: That is all.

Mr. Macdonald: That is all, Mr. Swan.

The Member: We will take five minutes recess.

(Whereupon a brief recess was taken after which proceedings were resumed as follows:)

Mr. Macdonald: Just one question, Mr. Swan, arising out of cross examination.

Redirect Examination

Q. (By Mr. Macdonald) Mr. Mather raised the question with reference to securities deposited by you with the bank, the Anglo bank, to secure the performance of the [222] agreement of sale of the stock under Petitioner's Exhibit 16.

(Testimony of Sherwood Swan.)

What was deposited with the Anglo bank?

A. There were two checks, one for \$15,000 from Harry Camp and one for \$10,000 from either Tom Riley or, T. C. Riley—I have forgotten what the initial is—for \$10,000, \$25,000 in all.

Q. When the sale was completed, when all the stock was sold, what was done with respect to that money so deposited?

A. It was promptly repaid.

Q. To those individuals?

A. To those individuals, \$15,000 to Camp and \$10,000 to Riley.

Q. Do you show on the statement of assets and liabilities as of December 16th herein, either that \$25,000 as an asset of yours or the obligation to repay the same as a liability?

A. No. I explained to Mr. Mather that I didn't keep books, and I ought to be scolded for it. But it is true, nevertheless. I never kept any personal books. I have notes and memorandums in my files, and I completely—I didn't consider either the assets side or the liability side on that transaction. In other words, I looked upon it as a wash transaction.

Q. What do you mean by "wash transaction"?

A. \$25,000 cash on one side and \$25,000 of notes on the [223] other that were used for a specific purpose and cleaned up and forgotten.

Mr. Macdonald: That is all.

(Witness excused.)

Mr. Macdonald: Mr. Murphy. [224]

The Clerk: That will be exhibit A.

(The said prospectus so offered and received in evidence was marked Respondent's Exhibit A, and is made a part of this record.)

Mr. Mather: I also offer in evidence the document marked "Respondent's Exhibit B for identification."

Mr. Macdonald: No objection.

The Clerk: Exhibit B.

(The said tax return so offered and received in evidence was marked Respondent's Exhibit B, and is made a part of this record.)

Mr. Macdonald: That is the tax return?

Mr. Mather: The tax return.

Mr. Macdonald: Very well.

Mr. Mather: Respondent rests.

The Member: Nothing in rebuttal?

Mr. Macdonald: No, sir. [230]

PETITIONERS' EXHIBIT 1

San Francisco, California,
March 14, 1930.

Mr. J. F. Carlston, President,
Central National Bank,
Oakland, California.

Dear Mr. Carlston:

It has just come to us that you contemplate asking Mr. Swan and Mr. Whitthorne to obligate the

securities recently pledged to you for an additional sum over the specified \$100,000.

This report leads us to mention our definite understanding in this regard that neither you nor we would look to the securities thus pledged to us in equal amounts for more than the \$100,000. each, this agreement being predicated upon our common judgment that it was mutually advantageous that Mr. Swan and Mr. Whitthorne should look forward to realizing for themselves upon any equity produced from the securities pledged over and above the total sum of \$200,000. We also have in mind that both Mr. Swan and Mr. Whitthorne pledged these to you and to us in the face of our mutual agreement referred to.

It is easily conceivable that this understanding may have escaped your memory at the moment. We accordingly are taking the liberty of thus mentioning it and also because we recognize the obligations thus entered into with Mr. Swan and Mr. Whitthorne as well as the advantages to you and to us of preserving an incentive for their continued endeavor.

Kind personal regards.

Cordially yours,

OSCAR L. COX,
Vice-President.

OLC:FCE

[Endorsed]: U. S. Board of Tax Appeals. Admitted in Evidence October 21, 1940. Petitioner's Exhibit 1. [231]

PETITIONERS' EXHIBIT 2

Central National Bank
Oakland, Calif.

March 15, 1930.

Mr. Oscar Cox, Vice-President,
Bank of Italy Natl. Trust & Savings Assn.,
San Francisco, California.

My dear Mr. Cox:

Responding to your letter of the 14th inst.

You are quite right in the assumption that we were to hold the collateral described in our new \$100,000.00 note, as security for this specific obligation. It was not intended, however, to forgive the indebtedness due by the individuals in excess of this amount. In other words, we are to continue to hold the Hale Bros. stock as security for such of the indebtedness as is in addition to the \$100,000 note. This I assume is in accordance with your understanding.

With kindest regards—

Yours very truly,

(signed) J. F. CARLSTON

President.

JFC:B

[Endorsed]: U. S. Board of Tax Appeals. Admitted in Evidence October 21, 1940. Petitioner's Exhibit 2. [232]

PETITIONERS' EXHIBIT 3

Bank of Italy

San Francisco, California

September 16, 1930.

Central National Bank

Oakland, California

Attention: Mr. Wainwright

Dear Mr. Wainwright:

Confirming our telephone conversation of today, our banks are in entire accord that some while ago we set at \$100,000. each the maximum principal amount of the indebtedness of either Mr. Swan or Mr. Whitthorne or both, for reimbursement of which we would look to Sherwood Swan & Company or the Sherwood Swan Company. This understanding occurred in the Spring, and it seemed that March 12 should be an appropriate date for setting aside out of our indebtedness from these individuals the sum of \$100,000. in accordance with the above.

On July 1, 1930 we received from Mr. Swan the sum of \$2,783.67, being one-half of certain funds owing as a receivable and paid to Mr. Whitthorne. This amount was applied as follows:

Interest from March 12 to July 1.....	\$ 1,850.00
---------------------------------------	-------------

For application upon principal.....	933.67
-------------------------------------	--------

\$ 2,783.67

Leaving principal amount due.....	\$99,066.33
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On this latter amount the interest from July 1, 1930 to October 1, 1930 amounts to \$1,489.13, and the interest thereafter per average month would be \$495.33.

Accordingly, it is my suggestion that at this month's meeting a dividend of twice the larger amount be declared, and a dividend authorized for each succeeding month of twice the lesser amount. This would provide service on both of our obligations for the remainder of the agreed amount, and it would be our purpose to set up these amounts as received as an interest reserve as against these notes, and at such later time as it may seem advisable the direct application could be made.

I mention all of the above for two purposes, first, to suggest that we reduce our \$100,000. obligation to some agreed sum, preferably to the one that we have used if you find the March 12 date a fair one to begin, and second, that the dividends mentioned above be declared at the next meeting. In connection with this latter matter I have clearly in mind that you and we are each fifty percent stockholders in the corporation and that if the situation should arise in which it seemed necessary and advisable that the company have additional funds, it would be a simpler transaction if the corresponding advances were made at that time and devoted to the special purpose then before us. [233]

I thank you for the word as to Mr. Swan's attitude toward his assignment and our keeping up the payments on some part of his life insurance.

When the matter has had your and his further consideration I would be interested in the result. Without close knowledge of the situation it would seem to us that our taking over some part of the \$250,000. you mention might easily be in the interests of both parties.

Cordially yours,

OSCAR L. COX (Signed)

Vice-President

[Endorsed]: U. S. Board of Tax Appeals. Admitted in Evidence October 21, 1940. Petitioner's Exhibit 3. [234]

PETITIONERS' EXHIBIT 4

April 22, 1931

Mr. Sherwood Swan
H. Liebes & Co.
Post and Grant Street
San Francisco, California

Dear Sherwood:

I have gone over a draft of agreement to be signed by Central National Bank of Oakland, Mr. Whitthorne and yourself with relation to the indebtednesses of Mr. Whitthorne and yourself or either of you to the bank.

Before the liquidation of Wasserman-Gattmann Co. was commenced, several conferences were had in Mr. Carlston's office all of which were attended by Mr. Carlston, Mr. Cox, you and the writer. The

final net result of those discussions was that you and Mr. Whitthorne would cooperate in every possible way both with the general creditors of Wasserman-Gattmann Co. and with your banking creditors to the end that the creditors of Wasserman-Gattmann Co. should receive as nearly as possible the full amount of their claims and be satisfied to accept in full payment of their demands the proceeds of the liquidation of the corporation named. The accomplishment of this purpose would make available for the banking creditors of Mr. Whitthorne and yourself the profits of the 10th Street Market and the value of the equity represented by the stock of the corporation owning it.

At the same time and as a part of the same arrangement, it was stated by the representatives of your banking creditors that every reasonable aid and assistance would be given you and Mr. Whitthorne in the working out of your financial situation so that you might ultimately recover for yourselves the 10th Street Market after having paid off to each of your banking creditors such sums as, under the circumstances, might fairly be allocated against the market stock.

Pursuant to the foregoing you and Mr. Whitthorne executed to the Central National Bank of Oakland your joint and several promissory note for \$100,000.00 and secured its [235] payment by the pledge of certain stock in Swan's, a California corporation, in Wasserman-Gattmann Co., and (the important security) 500 shares or one-half of the

stock of Sherwood Swan & Company, Ltd. The pledge of 500 shares of stock of Sherwood Swan & Company, Ltd. was subject to a prior pledge to the writer of this letter. Sometime in the year 1930 the writer sold this stock under his pledge and on August 1, 1930 the writer sold this 500 shares to the Central National Bank of Oakland and certificate No. 33, representing the same was issued to George C. Humphrey.

From what was said and done in 1930, including the conferences first mentioned in this letter and the execution by yourself and Mr. Whitthorne of the \$100,000.00 note secured by 500 shares of stock of Sherwood Swan and Company, Ltd., it was your understanding (an understanding which I share) that if you and Mr. Whitthorne were able to pay off the above mentioned \$100,000.00 note and a similar \$100,000.00 note, at the same time executed to the Bank of Italy, and the two banks were reimbursed in the sum of \$35,000.00 and certain interest, which you and Mr. Whitthorne owed me, and for the payment of which all the stock in Sherwood Swan and Company, Ltd. was primarily pledged, you and Mr. Whitthorne would be given an opportunity to recover the stock of Sherwood Swan and Company, Ltd. In the very nature of things nothing was said and nothing could specifically have been said regarding the length of time during which the banks would wait for the working out of the market problem and the repayment to them of

\$200,000.00 secured by its stock. It was recognized that the equity in the market was small in proportion to the indebtedness against the real estate; that without refinancing of the real estate obligations there was not much hope of cleaning up the situation so that you and Mr. Whitthorne could repurchase the stock of Sherwood Swan and Company, Ltd.; but it was also indicated that in determining how long the banks would wait for such refinancing fair consideration would be given to the completely cooperative conduct of Mr. Whitthorne and yourself. I believe the foregoing is an accurate statement of what came out of the conferences between your banking creditors and yourself in the spring of 1930. [236]

It is to be noted that the note for \$250,000.00 attached to the proposed agreement consolidates all of the security heretofore pledged, which means that the allocation of \$100,000.00 against the Central National Bank's half of the market stock is eliminated.

I note also that \$20,000.00 now owed by you separately is made a joint obligation of Mr. Whitthorne and yourself.

It appears also that the interest rates on your primary obligations are maintained at 6%. The present Hale dividends service \$150,000.00 at 4%; the present market dividends service \$100,000.00 at 5% and \$20,000.00 at 5%. With the obligations in the primary notes running at 6% you have a con-

stantly accumulating arrearage of interest which makes progressively unlikely your ever cleaning up your financial obligations in full.

I also note that you purport to pledge 500 shares of stock in Sherwood Swan & Company, Ltd., which, so far as I know, do not belong to you. Of course, there are ways of making provision to cover this last point but as matters now stand you have, so far as I know, no legal interest in the shares of stock mentioned.

You have asked me to read over the draft of agreement submitted to you and to advise you regarding the meaning of the same. In doing so I have found it necessary to review the whole situation rather extensively. I suggest that the whole matter is an appropriate subject of conversation between Mr. Carlston and yourself.

Very truly yours,

HARRISON S. ROBINSON

[Endorsed]: U. S. Board of Tax Appeals. Admitted in Evidence October 21, 1940. Petitioner's Exhibit 4. [237]

PETITIONERS' EXHIBIT 5

Bank of America N. T. & S. A.

San Francisco, California,

April 24, 1931.

Mr. Harrison S. Robinson,
Financial Center Building,
Oakland, California.

Dear Harrison:

Referring to your letter of April 23, 1931 and the attached copy of a proposed letter to Sherwood Swan dated April 22, it was definitely understood in conference and has been confirmed in correspondence with the Central National Bank that neither the Central nor ourselves would look to the Tenth Street Market situation for more than \$100,000 to each of us. It may be that the general pledge and consolidation of debt should be supplemented by the Central giving Mr. Swan a letter to this effect. Mr. Swan is welcome to access to our files to substantiate that the agreement was made as mentioned.

We assume that Mr. Swan will not pledge the 500 shares of Sherwood Swan and Company, Ltd. without finding a way to make a similar pledge to us should we prefer.

I am not altogether clear as to the apparent duplication of notes mentioned in the second paragraph of your letter, but recognize that this is not a matter with which we are directly concerned. I see no impolicy in addressing your letter to Mr.

Swan, assuming of course that neither he nor you will understand that we are recognizing an obligation to hold the Market stock for any given period. We have no such obligation. On the other hand, we have assured Mr. Swan that as long as we have the stock we shall be glad to surrender it to him when we have realized \$100,000 principal therefrom.

Cordially yours,

OSCAR L. COX

Vice-President

OLC:FCE

[Endorsed]: U. S. Board of Tax Appeals. Admitted in Evidence October 21, 1940. Pet.'s Ex. 5. [238]

PETITIONERS' EXHIBIT 6

Bank of Italy

National Trust & Savings Association

Head Office

San Francisco, Cal.

San Francisco, California,

May 20, 1931.

Mr. Sherwood Swan,
167 Post Street,
San Francisco, California.

Dear Sherwood:

Complying with your request of May 16, 1931, we enclose copies of certain correspondence, being

letter dated March 14, 1930 to the Central National Bank and Mr. Carlston's reply under date of March 15, 1930.

You already have copy of our letter of September 16, 1930 to the Central National Bank, to which their reply was a verbal assurance of Mr. Wainwright to our Mr. Johnson who reported to us as follows under date of September 23:

"Mr. Wainwright stated also, he was in full accord with your letter of September 16 addressed to his attention and that the Central Bank was willing to accept the figures outlined in that letter and the dates suggested, as a basis for all future payments."

Cordially yours,

O. L. COX,

Vice-President.

OLC:FCE

2 Encls.

cc—Mr. Harrison S. Robinson.

[Endorsed]: U. S. Board of Tax Appeals. Admitted in Evidence October 21, 1940. Petitioner's Exhibit 6. [239]

PETITIONERS' EXHIBIT 7

Bank of America
National Trust & Savings Association

Oscar L. Cox
Vice-President

San Francisco, California,

June 1, 1931.

Mr. Sherwood Swan,
167 Post Street,
San Francisco, California.

Dear Mr. Swan:

Enclosed is the agreement submitted to you and Mr. Whitthorne by the Central National Bank, and which you sent us in your letter of May 28, 1931 with request as to whether this agreement would prejudice your position with us.

It is our desire to accommodate ourselves to the convenience of Mr. Carlston and his associates as you know, but we should regret to see you obligate yourselves so that:

1. Your total outstanding notes would exceed your total debt, and,

2. One-half the stock previously held by you in Sherwood Swan & Company, Ltd. would be pledged for more than \$100,000.

As to the first point, I take it that the multiple notes are intended to provide immediate payment of 4% and/or 5% but an ultimate payment of 6%. It would seem to us that the ultimate result should

be obtained by a covering letter and a single series of notes. As to the second point, that was covered by definite agreement made in your presence in the early stage of the Whitthorne-Swan negotiations and was confirmed in an exchange of letters between Mr. Carlston and the writer, copies of which we are pleased to hand you.

In view of the cordial cooperation of the Central National in the various mutual matters which we have had in connection with the undertakings in which you have been interested, and as this letter has at your invitation discussed certain of their procedure, it seemed appropriate to send a copy of this letter to Mr. Carlston and a carbon is therefore attached for your delivery.

Kindest regards!

Cordially yours,

O. L. COX,

Vice-President.

OLC:FCE [240]

Robinson, Price & Macdonald
Attorneys at Law
Sixteenth Floor
Financial Center Building
Oakland, California

August 12, 1931

Mr. Sherwood Swan
167 Post Street
San Francisco, California

Dear Sherwood:

I am returning you herewith your letter to me dated July 31, 1931 with its inclosed notes and memorandum from the Central Bank. I am also sending you herewith Mr. Cox's letter to me on the same subject matter dated August 7, 1931.

I have the following comments to make:

1. Both banks seem to desire to use unmodified their printed form of collateral security agreement. Which contains a blanket clause stating that the enumerated securities and collaterals are **also security** for any other notes which the signer of the collateral agreement may make.

It is not improbable that under all the circumstances both banks would be held to their contract to limit the charges against the Tenth Street Market stock to \$200,000.00 and interest. The absolutely safe protection for you would be an additional clause in the contract between you and the two banks stating expressly that any clause in any collateral security agreement reciting that any of the

market stock is further security for any notes other than the \$100,000.00 to each bank is not operative as to any market stock.

The next most satisfactory procedure would be a letter from you accompanying the notes, calling attention to the printed form under discussion, stating that the special agreement excepts all market stock from the operation of such clause and asking the confirmation of that statement by the banks.

2. This brings us to the matter of the \$1150.00 note. The Central Bank, as I understand it, is clearly violating the arrangement regarding the application of dividends received from the market stock in not applying [241] the whole of the same to the \$100,000.00 which has been allocated against the market. If there is a deficiency in interest doubtless it is in order for you to sign a note for such deficiency but, as I see it, it is clearly out of order for you to sign a collateral trust agreement pledging the market stock for the \$1150.00 note.

Very truly yours,

HARRISON S. ROBINSON.

[242]

PETITIONERS' EXHIBIT 9

Description of Real Property of Sherwood Swan and Company, Ltd. Held in December, 1936.

All that certain real property situate in the City of Oakland, County of Alameda, State of California, more particularly described as follows:

Commencing at the intersection of the Westerly line of Washington Street with the Southerly line of Tenth Street; thence Westerly on said line of Tenth Street three hundred (300) feet to the easterly line of Clay Street; thence Southerly on said line of Clay Street one hundred (100) feet; thence easterly parallel with the said line of Tenth Street seventy-five (75) feet; thence Southerly parallel with said line of Washington Street one hundred (100) feet to the Northerly line of Ninth Street; thence easterly on said line of Ninth Street seventy-five (75) feet; thence Northerly parallel to said line of Washington Street one hundred (100) feet; thence easterly parallel with said line of Tenth Street one hundred (100) feet to said Westerly line of Washington Street; thence Northerly on said line of Washington Street one hundred (100) feet to the point of commencement.

[Endorsed]: U. S. Board of Tax Appeals. Admitted in Evidence October 21, 1940. Petitioner's Exhibit 9 [243]

PETITIONERS' EXHIBIT 10

Sherwood Swan

STATEMENT OF ASSETS AND LIABILITIES

December 16, 1936

(Based upon lack of any fair market value for common stock)

ASSETS

Current Assets:

Due from Sherwood Swan & Company, Ltd..... \$ 9,835.12

Investments:

Sherwood Swan and Company, Ltd. capital stock—500 shares—fair market value (exchanged on December 21, 1936 for 15,000 Class A shares having fair market value of \$7.00 per share and 22,500 shares common stock)\$105,000.00

Ranch situated in Madera County, California —held under mortgage by Bank of America (contra)—approximate market value.....	6,000.00	111,000.00
		<hr/>
		<u>\$120,835.12</u>

LIABILITIES

Current Liabilities:

Notes payable—

Bank of America—secured by first mortgage on ranch situated in Madera County, California (contra)\$ 10,000.00

Central Company (one-half of joint indebtedness of Sherwood Swan and W. R. Whitthorne totaling \$20,000)..... 10,000.00

Anglo California National Bank (one-half of joint indebtedness of Sherwood Swan and W. R. Whitthorne in the respective total sums of \$175,000 and \$5,000)..... 90,000.00

David S. Wasserman.....	5,000.00	\$115,000.00
		<hr/>

Accounts payable—

Helen L. Swan.....	\$	4,788.00	
Charles Raphael		500.00	
Harry Camp		7,500.00	
Orrick, Palmer & Dahlquist (one-half of joint indebtedness of Sherwood Swan and W. R. Whitthorne totaling \$2,000).....		1,000.00	
T. E. Louis.....		725.10	
R. L. Underhill.....		200.00	
George D. Roberts.....		500.00	
McKinstry, Haber & Pierce Coombs.....		300.00	
Moose Club		58.50	15,571.60

Accrued taxes—

Federal income taxes on 1936 income except that on sale of Sherwood Swan & Com- pany, Ltd. stock and alleged gain on dis- charge of bank indebtedness.....	\$	620.78	
California state income taxes on 1936 in- come accrued to December 16, 1936 (based upon same inclusions as federal tax).....		143.57	764.35

Sherwood Swan—Net Insolvency..... 10,500.83*

\$120,835.12

*Denotes red figure.

[Endorsed]: U. S. Board of Tax Appeals. Ad-
mitted in evidence October 21, 1940. Petitioner's
Exhibit 10. [244]

PETITIONERS' EXHIBIT 13

In the District Court of the United States, for
the Northern District of California, Southern
Division

No. 3591 S

In the Matter of the Receivership of the

CENTRAL NATIONAL BANK

OF OAKLAND,

a national banking association.

PETITION FOR AUTHORITY
TO COMPROMISE INDEBTEDNESS

The petition of Joseph H. Grut, Receiver of the
Central National Bank of Oakland, a national bank-
ing association, respectfully represents unto the
court as follows:

I.

That Central National Bank of Oakland is a
national banking association organized under the
laws of the United States and is hereinafter re-
ferred to as the national bank. That prior to March
14, 1933, said national bank was engaged in busi-
ness as such national banking association in Oak-
land, California. That on May 8, 1933, petitioner
was duly appointed Receiver of said national bank
by the Comptroller of the Currency of the United
States, and ever since has been and now is the duly
appointed, qualified and acting Receiver of said
Central National Bank of Oakland, a national bank-
ing association.

II.

That petitioner, as such Receiver, has taken possession of and is now in possession of the assets of said national bank, and [245] particularly the following promissory notes:

(a) Promissory note dated June 28, 1931, in the sum of \$100,000.00, payable on demand to Central National Bank of Oakland, bearing interest at six per cent per annum, executed by W. R. Whitthorne and Sherwood Swan, upon which there is now due the sum of \$13,080.32, together with accrued interest from February 2, 1933.

(b) Promissory note dated January 24, 1933, in the sum of \$15,000.00, payable on demand to Central National Bank of Oakland, bearing interest at six per cent per annum, executed by W. R. Whitthorne and S. B. Swan, upon which there is now due the sum of \$15,000.00, together with accrued interest from April 14, 1933.

(c) Promissory note dated Jan. 24, 1933, in the sum of \$85,000.00, payable on demand to Central National Bank of Oakland, bearing interest at six per cent per annum, executed by W. R. Whitthorne and S. B. Swan, upon which there is now due the sum of \$85,000.00, together with accrued interest from April 18, 1933.

(d) Promissory note dated April 30, 1933, in the sum of \$66,000.00, payable on demand to

Central Bank of Oakland, bearing interest at six per cent per annum, executed by W. R. Whitthorne and Sherwood Swan, upon which there is now due the sum of \$1.00, together with accrued interest.

(e) Promissory note dated July 11, 1935, in the sum of \$25,664.67, payable on demand to Central Company, bearing interest at six per cent per annum, executed by Sherwood Swan, upon which there is now due the sum of \$25,664.67, together with interest from July 11, 1935.

(f) Promissory note dated July 11, 1935, in the sum of \$73,369.05, payable on demand to Central Company, bearing interest at six per cent per annum, executed by W. R. Whitthorne and Sherwood Swan, upon which there is now due the sum of \$73,369.05, together with interest from July 11, 1935.

That there is now due, owing and unpaid upon said promissory notes the aggregate principal sum of \$212,115.04, together with accrued interest.

That said indebtedness is secured by the following: [246]

500 shares of the capital stock of Sherwood Swan and Company, Ltd.

2000 shares of the capital stock of Swan's, a corporation

1725 shares of the capital stock of Wasserman-Gattman, a corporation

Life insurance policy of Western States Life Insurance Company, No. 240295, in the sum of \$50,000.00, insuring the life of Sherwood Bertram Swan.

That petitioner is informed and believes and therefore alleges that all of said security except said 500 shares of the capital stock of Sherwood Swan and Company, Ltd., is valueless.

III.

That said Sherwood Swan has offered to compromise and settle said indebtedness, as aforesaid, by paying to your petitioner, as Receiver, the sum of \$75,000.00 cash and by giving to your petitioner a promissory note in the sum of \$20,000.00, payable in five years in annual instalments of \$4,000.00, bearing no interest, said note to be executed by Sherwood Swan and W. R. Whitthorne.

IV.

That your petitioner is informed and believes and therefore alleges that said Sherwood Swan and W. R. Whitthorne are insolvent and unable to pay their obligations in full, and that said offer of compromise and settlement is the largest and best offer obtainable, and that it is for the best interests of your petitioner's trust that said offer of compromise and settlement be accepted.

V.

That the Shareholders' Committee of the Central National Bank of Oakland, and the Central Company, have given petitioner their [247] written consent and recommendation of said compromise; and that the Comptroller of the Currency of the United States has authorized said compromise, a copy of which authorization is hereto attached, marked "Exhibit A" and by reference made a part hereof.

Wherefore, petitioner prays that this court make its order or orders authorizing petitioner to settle and compromise the obligations set forth herein upon receiving as consideration therefor the sum of \$75,000.00 cash and a promissory note in the sum of \$20,000.00, payable in five years in annual installments of \$4,000.00, bearing no interest, and executed by Sherwood Swan and W. R. Whitthorne, and that upon receiving said consideration petitioner be authorized to deliver to the owners thereof, or their nominee, the notes and collateral security securing the same, and to execute and deliver such other documents as may be necessary to effectuate said compromise.

JOSEPH H. GRUT

Receiver of Central National Bank of Oakland,
a national banking association, in
liquidation

FRANK S. RICHARDS

Attorney for Receiver

Verification by Joseph H. Grut December 14,
1936. [248]

CERTIFICATE OF SETTLEMENT

Hon. Comptroller of the Currency
Div. Insolvent National Banks
Washington, D. C.

December 16, 1936.

Sir:

Under an agreement of settlement made with J. H. Grut, Receiver of the Central National Bank of Oakland, we hereby certify that we have delivered to said Receivers:

- | | |
|---|-------------|
| (a) Cash in the amount of..... | \$75,000.00 |
| (b) Our promissory note dated December 16, 1936 for | 20,000.00 |

Payable to the order of Central National Bank; in installments of Four Thousand Dollars (\$4,000.00) or more on the 15th day of December of each year, beginning on the 15th day of December, 1937, and continuing until said sum has been paid in full, without interest.

\$95,000.00

in full compromise settlement of the promissory notes held by J. H. Grut, as Receiver of the Central National Bank of Oakland, described as follows:

- | | |
|--|-------------|
| Asset #1224, note signed by W. R. Whitthorne and Sherwood Swan; unpaid principal balance | \$13,080.32 |
| Asset #1225, note signed by W. R. Whitthorne and S. B. Swan; unpaid principal balance..... | 15,000.00 |
| Asset #1226, note signed by W. R. Whitthorne and S. B. Swan; unpaid principal balance..... | 85,000.00 |
| Asset #1227, note signed by W. R. Whitthorne and Sherwood Swan; unpaid principal balance | 1.00 |

Asset #4933, note signed by W. R. Whitthorne
and Sherwood Swan; unpaid principal bal-
ance 73,369.05

Asset #4898, note signed by Sherwood Swan;
unpaid principal balance..... 25,664.67

Respectfully

SHERWOOD SWAN

W. R. WHITTHORNE

Witness:

T. H. THARP (?)

Receivers' letter of recommendation—December 2,
1936

Office letter of approval—December 7, 1936

Court Order—December 15, 1936

(Receiver's Copy) (Copy mailed compt. 12-17-36)

[249]

PETITIONERS' EXHIBIT 14

In the District Court of the United States, for
the Northern District of California, Southern
Division

No. 3591 S

In the Matter of the Receivership of the

CENTRAL NATIONAL BANK

OF OAKLAND,

a national banking association.

ORDER AUTHORIZING COMPROMISE

OF INDEBTEDNESS

The verified petition of Joseph H. Grut, Receiver
of Central National Bank of Oakland, a national

banking association, in liquidation, heretofore filed herein, coming on regularly for hearing this 15th day of December, 1936, before the above entitled court, said Receiver being represented in court by A. W. Carlson, Esq., appearing for Frank S. Richards, Esq., his attorney, and no one appearing in opposition thereto, and it appearing to the court and the court finds that all of the allegations of said petition are true and that it is for the best interests of said Receiver's trust that said petition be granted; and it further appearing to the court and the court finds that said petitioner has been duly authorized in writing by the Comptroller of the Currency of the United States to settle and compromise the indebtedness as in said petition and hereinafter set forth; and good cause appearing therefor,

It is hereby ordered, adjudged and decreed as follows: [250]

That said petitioner, Joseph H. Grut, as Receiver of Central National Bank of Oakland, a national banking association, in liquidation, be, and he is hereby authorized to compromise and settle the indebtedness of Sherwood Swan and W. R. Whitthorne, as set forth in said verified petition, upon receiving as consideration therefor the sum of \$75,000.00 cash and a promissory note in the sum of \$20,000.00, payable in five years in annual installments of \$4,000.00, bearing no interest, and executed by Sherwood Swan and W. R. Whitthorne. That petitioner be, and he is further authorized upon receipt of said consideration to deliver to the

owners thereof, or their nominee, the notes and collateral security securing the same, and to execute and deliver such documents as may be necessary to effectuate the authority herein contained.

Done in open court this 15th day of December, 1936.

A. F. ST. SURE

Judge of the United States
District Court

(Seal of the U. S. District Court)

[Endorsed]: Filed Dec. 15, 1936. Walter B. Maling, Clerk. By J. P. Welsh, Deputy Clerk.

[251]

PETITIONERS' EXHIBIT 15

CERTIFICATE

I, Matt Wahrhaftig, do hereby certify as follows:

On December 16, 1936, I was duly authorized by Bank of America N. T. & S. A. to hold a Pledge Sale of the securities hereinafter described under two Pledge Agreements, one dated March 1, 1933, executed by Sherwood Swan and W. R. Whitthorne, and the other dated April 26, 1934, executed by Sherwood Swan, which said Pledge Agreements and the securities hereinafter referred to were given to secure the following promissory notes:

Note dated March 1, 1934, in the principal amount of \$99,066.33, executed by Sherwood Swan and W. R. Whitthorne to Bank of America N. T. & S. A.;

Note dated April 1, 1934, executed by Sherwood Swan to said Bank, in the principal amount of \$67,909.07;

Note dated April 1, 1934, executed by Sherwood Swan to said Bank, in the principal amount of \$15,863.62;

Note dated July 18, 1934, executed by Sherwood Swan to said Bank in the principal amount of \$560.01;

On which said four notes there was a balance due at the time of the Sale hereinafter referred to of \$196,073.14 (being the amount due after the application of \$931.95 dividend from Hale Bros. Realty Co.).

On the said 16th day of December at the hour of 11:45 A. M. thereof and at the office of J. H. Grut, Receiver of Central National Bank, Central Bank Building, Fourteenth Street and Broadway, Oakland, California, and in the presence of the following persons, to-wit:

Sherwood Swan
W. R. Whitthorne
P. D. Richardson
J. H. Grut
Lawrence Tharp
Wallace W. Knox

I offered for sale the securities held in pledge by Bank of America N. T. & S. A. in the following manner:

I referred to the said four promissory notes, which were present at said Sale and in my possession. I referred to the said two Pledge Agreements, which were [252] present at the Sale and in my possession. I then described in detail the securities hereinafter described, which were then present at said Sale and in my possession. I then asked whether Sherwood Swan or W. R. Whitthorne had any objections to the making of the Sale or to the time and place of the sale, or whether they wished more notice thereof, or whether they wished demand of performance, or whether they wished the Sale continued to any other place, and said Sherwood Swan and W. R. Whitthorne each stated that he was satisfied with having the Sale held at that time, waived any and all notice thereof, and requested that I proceed with the Sale, specifically waiving, and each of them did waive, any and all rights to receive any additional notice given them by the Statutes of the State of California.

I thereupon asked whether anyone present desired any parcel of stock offered for sale separately.

Sherwood Swan thereupon requested the *the* five hundred shares of capital stock of Sherwood Swan and Company, Ltd., a California corporation, evidenced by the following certificates:

Certificate No. 35 for 497 shares;

Certificate No. 29 for 1 share;

Certificate No. 30 for 1 share;

Certificate No. 31 for 1 share;

be offered for sale, and I thereupon offered the said certificates for sale and said Sherwood Swan bid the sum of \$100,000.00 therefor and, there being no other and further bidders, I accepted the said sum of \$100,000.00 from said Sherwood Swan on behalf of said Bank and declared that he was the successful bidder at the Sale and caused the said certificates to be transferred to him.

I thereupon asked whether any person present desired that the remaining securities be offered for sale separately. No one requested that said securities be sold separately. I asked said Sherwood Swan and W. R. Whitthorne severally whether they or either of them desired the remaining securities sold separately and they stated that they did not.

I thereupon offered the remaining securities, consisting of two thousand seventy-one shares of capital stock of Hale Bros. Realty Co., two thousand shares of capital stock of Swan's, and seventeen hundred twenty-five shares of capital stock of Wasserman-Gattmann Co., for sale, and Bank of America N. T. & S. A. bid for said cer- [253] tificates the amount of \$96,073.14 and, there being no other bidders and the said Bank being the highest and best bidder, I declared the said securities sold to said Bank of America N. T. & S. A.

I thereupon declared that the said amount so bid by said Bank constituted full payment of the four notes above referred to, and that W. R. Whitthorne and Sherwood Swan were entitled to the

delivery to them of said promissory notes, marked "Paid".

I witness whereof, I have executed this certificate this 16th day of December, 1936.

(signed) MATT WAHRHAFTIG [254]

PETITIONERS' EXHIBIT 17

December 31, 1930

Mr. David Wasserman
Sacramento, California

Dear Sir:

The undersigned, makers of a promissory note in the principal sum of \$100,000.00 now payable to and held by you, advise you that we are utterly unable to pay this note or any interest thereon or any part of the principal out of any funds or assets now belonging to us.

You are now settling our liability under this note and forgiving us of our indebtedness thereunder on the receipt of Five Thousand Dollars (\$5,000.00) in cash and the promissory note of Sherwood Swan for an additional sum of Five Thousand Dollars (\$5,000.00).

You are advised that the \$5,000.00 which you are receiving in cash has been secured by us from others and is not out of our own assets.

Yours truly,

W. R. WHITTHORNE

SHERWOOD SWAN [275]

\$5,000.00

Oakland, California,
December 31, 1930

For Value Received I promise to pay to David Wasserman or order at Sacramento, California, the sum of Five Thousand Dollars in lawful money of the United States as follows:

Three Hundred and Fifty (\$350.00) Dollars on the 1st day of February, 1932; and Three Hundred and Fifty (\$350.00) Dollars on the first day of each and every month thereafter until the entire principal sum of \$5,000.00 has been fully paid.

I further agree to pay interest at the rate of six per cent (6%) per annum, payable monthly, on all unpaid portions of the principal sum of this note.

In case any installment of principal or of interest is not paid within thirty (30) days after the same becomes due, then at the option of the payee of this note, the entire unpaid balance hereof, both principal and interest shall become immediately due and payable.

In case suit is brought to collect this note or any part thereof I agree to pay a reasonable sum for attorney's fees in such suit.

SHERWOOD SWAN

WALLACE W. KNOX

Witness to Signature [276]

PETITIONERS' EXHIBIT 19
Sherwood Swan and Company, Ltd. and Subsidiaries
CONSOLIDATED BALANCE SHEET
As at December 31, 1936

[illegible]

[illegible]

UNLESS HEREOF ACCEPTS THIS DRAFT IN FULL PAYMENT OF THE DEBT HEREIN STATED. FURTHER RECEIPT NOT WANTED

Pay

DOLLARS

WOOL CERTIFICATE OF PURCHASE. FURTHER RECEIPT NOT NEEDED.
 States and must be paid in full to the
 100% Woolmark 23 and 64's

\$423⁶⁴.

Sherwood Swan and Company, Ltd.

Stanley J. ... PRESIDENT
... COMPTROLLER

4216

85-20

90-22
TO THE

ANGLO CALIFORNIA NATIONAL BANK OAKLAND BRANCH

PAY TO THE ORDER OF
FEDERAL RESERVE BANK
of San Francisco, Cal.

Bank or Banker
Clearing House
INVESTMENTS GUARANTEED

JUN 10 1937

JUN 10 1937

11-37 INTERNAL DEVENHUE COLLECTIONS
OF SAN FRANCISCO JOHN V. LEWIS Coll. Int. Rev.
SAN FRANCISCO, CALIFORNIA JOHN V. LEWIS

U.S. BOARD OF TAX APPEALS
DIV. 10
DOCKET
NOTED IN EVIDENCE
OCT 21 1940
PETITIONERS
RESPONDENTS
EXHIBIT
20

55-21

PETITIONERS' EXHIBIT 21

Sherwood Swan and W. R. Whitthorne

CALCULATION OF PRESENT VALUE OF NON-INTEREST BEARING NOTE TO CENTRAL NATIONAL BANK DATED DECEMBER 16, 1936.

Rate of discount adopted—6% per annum.

Present value of annuity of \$2,000 per annum for four years, payable at end of each year, at 6% interest compounded annually

2000 x 3.46511* = Value at December 16, 1937.....\$6,930.22

Payment due December 16, 1937..... 2,000.00

\$8,930.22

Discounted at 6% simple interest for period May 18, 1937 to

December 16, 1937—213 days (.06(213/365)) (8930.22)..... 311.74

\$8,618.48

*Present value of payment due December 16, 1938 (1/1.06) .94340

39 (.9434/1.06) .89000

40 (.89/1.06) .83961

41 (.83961/1.06) .79210

3,46511

[303]

PETITIONERS' EXHIBIT 22

Sherwood Swan and Estate of W. R. Whitthorne
 ALLOCATION OF COST BASIS OF SHERWOOD SWAN &
 COMPANY, LTD. OLD STOCK ENTIRELY TO NEW
 CLASS A SHARES DECEMBER 21, 1936.

	Shares	Cost
Total Cost:		
Class A shares.....	30,000	\$100,000.00
Common shares	45,000	None
		<hr/>
		\$100,000.00
		<hr/>
Swan and Whitthorne (each):		
Class A shares.....	15,000	\$ 50,000.00
Common	22,500	None
		<hr/>
		\$ 50,000.00
		<hr/>
Allocation to Class A shares sold:		
Total shares owned each by Swan and Whitthorne	15,000	
	<hr/>	
Total cost	\$50,000.00	
	<hr/>	
Cost per share.....	\$3.333	
	<hr/>	
Sold 1936 (6250 x \$3.334).....	\$20,833.33	
	<hr/>	
Sold 1937 (6250 x \$3.334).....	\$20,833.33	
	<hr/>	

In the United States Circuit Court of Appeals
for the Ninth Judicial Circuit

B.T.A.

Docket No. 101189

MINNIE L. WHITTHORNE and EVA WHIT-
THORNE, Executrices, ESTATE OF W. R.
WHITTHORNE, deceased,
Petitioners on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

B.T.A.

Docket No. 101190

SHERWOOD SWAN,
Petitioner on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

STIPULATION

It is hereby stipulated by and between the parties
above named that in the preparation of the record
for review of the above entitled appeals before the
United States Board of Tax Appeals, the following
portion of the reporter's transcript may be omitted:

Page 68, l. 1 to page 72, l. 21, inclusive
Page 74, l. 7 to page 75, l. 11, inclusive
Page 136, l. 21 to page 139, l. 12, inclusive
Exhibit No. 11
Exhibit No. 12

Dated: February 5th, 1942.

R. W. MACDONALD

Attorney for Petitioners on Review

J. P. WENCHEL

Attorney for Commissioner of Internal
Revenue, Respondent on Review [330]

[Title of Circuit Court of Appeals and Cause.]

ORDER

On reading and filing the Stipulation of the parties to the above entitled causes and good cause appearing therefor,

It is hereby ordered that a single record in the matter of the above entitled proceedings may be prepared for use on appeal before the United States Circuit Court of Appeals for the Ninth Judicial Circuit and that said appeals may be consolidated for hearing before said Circuit Court of Appeals.

Dated: February 27, 1942.

FRANCIS A. GARRECHT

Judge of the United States Circuit Court of
Appeals for the Ninth Judicial Circuit

True Copy. Attest Feb. 27, 1942. Paul P.
O'Brien, Clerk. By Frank H. Schmid, Deputy.

[Endorsed]: Filed Feb. 27, 1942. Paul P. O'Brien,
Clerk. [331]

[Title of Board and Cause—Docket Nos. 101189,
101190.]

CERTIFICATE

I, B. D. Gamble, Clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 334, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 9th day of March, 1942.

(Seal)

B. D. GAMBLE,

Clerk,

United States Board of Tax Appeals

[Endorsed]: No. 10087. United States Circuit Court of Appeals for the Ninth Circuit. Minnie L. Whitthorne and Eva Whitthorne, Executrices of the Estate of W. R. Whitthorne, deceased, Petitioners, vs. Commissioner of Internal Revenue, Respondent, and Sherwood Swan, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petitions to Review

Decisions of the United States Board of Tax Appeals.

Filed March 16, 1942.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

[Title of Circuit Court of Appeals and Cause.]

STIPULATION

It is hereby stipulated by and between the parties above named that a single record in the matter of the above entitled proceedings may be prepared for use on appeal before the United States Circuit Court of Appeals for the Ninth Judicial Circuit and that said appeals may be consolidated for hearing before said Circuit Court of Appeals.

Dated: February 5th, 1942.

R. W. MACDONALD

Attorney for Petitioners on Review

J. P. WENCHEL

Attorney for Commissioner of Internal Revenue, Respondent on Review

[Title of Circuit Court of Appeals and Cause.]

ORDER

On reading and filing the Stipulation of the parties to the above entitled causes and good cause appearing therefor,

It is hereby ordered that a single record in the matter of the above entitled proceedings may be prepared for use on appeal before the United States Circuit Court of Appeals for the Ninth Judicial Circuit and that said appeals may be consolidated for hearing before said Circuit Court of Appeals.

Dated: February 27th, 1942.

FRANCIS A. GARRECHT

Judge of the United States Circuit Court of
Appeals for the Ninth Judicial Circuit

[Endorsed]: Filed Feb. 27, 1942.

[Endorsed]: Refiled Mar. 16, 1942.

[Title of Circuit Court of Appeals and Cause.]

STATEMENT OF POINTS ON WHICH
APPELLANT INTENDS TO RELY ON
APPEAL

I.

Taxpayers did not realize taxable income by reason of cancellation by banks of their indebtedness during the taxable year.

1. Stock in Sherwood Swan and Company, Ltd. which was released by banks in taxable year 1936 had in 1930 been freed from pursuit from all bank indebtedness except \$200,000.

2. In determining taxpayers' solvency or insolvency after the cancellation of indebtedness, assets freed from the burden of debt by

the cancellation cannot be valued at any amount in excess of their cost basis to taxpayers.

3. Using cost as the proper valuation of the assets freed, taxpayers did not receive any taxable income incident to the release of such assets and the cancellation of indebtedness.

4. Any income to taxpayers incident to the release of assets occasioned by the cancellation of indebtedness, cannot exceed the net fair market value in the taxable year of the assets so released.

5. Using the fair market value basis, taxpayers did not realize taxable income by reason of cancellation of indebtedness.

II.

The fair market value of the common stock of Sherwood Swan and Company, Ltd. in the taxable year cannot be determined; accordingly, the entire cost to taxpayers of the Sherwood Swan and Company, Ltd. stock should be applied as the basis for the Class A preferred stock sold by them.

III.

There was reasonable cause for the one day delay of taxpayers in the filing of their return and taxpayers should be relieved from the penalty imposed.

R. W. MACDONALD

Attorney for Petitioners—Appellants.

No. 10,087

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

MINNIE L. WHITTHORNE and EVA WHIT-
THORNE, Executrices of the Estate of
W. R. Whitthorne, Deceased,

Petitioners,

VS.

COMMISSIONER OF INTERNAL REVENUE,

Respondent,

and

SHERWOOD SWAN,

Petitioner,

VS.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

OPENING BRIEF OF PETITIONERS-APPELLANTS.

ROBERT W. MACDONALD,

Financial Center Building, Oakland, California,

*Attorney for Petitioners-
Appellants.*

ROBINSON, PRICE & MACDONALD,

Financial Center Building, Oakland, California,

Of Counsel.

FILED

JUL 3 1942

PAUL F. O'BRIEN

Subject Index

	Page
Statement of Facts	2
Statement of the Points Upon Which Petitioners Rely.....	13
Argument	14
I. By the March, 1930 agreement, the banks released the Sherwood Swan and Company, Ltd. stock from pursuit except to the amount of \$100,000 to each bank, thus immediately freeing that stock from all demands in excess of \$200,000, and thus any gain occasioned by such freeing of assets took place in 1930	14
II. Any income to petitioners incident to the release of assets occasioned by the cancellation of indebtedness cannot exceed the cost basis of such assets to taxpayer	22
III. Using cost as the proper valuation of the assets freed, petitioners did not receive any taxable income incident to the release of such assets and the cancellation of indebtedness	26
IV. Any income to petitioners incident to the release of assets occasioned by the cancellation of indebtedness cannot exceed the net fair market value of the assets so released.....	29
V. Using the fair market value basis, petitioners did not receive any taxable income incident to the release of assets for the cancellation of indebtedness	31
VI. The entire cost to petitioners of the Sherwood Swan and Company stock should be applied as the basis for the Class A preferred stock sold by them rather than simply an allocated percentage thereof.....	32
VII. There was reasonable cause for the apparent one-day delay of petitioners in the filing of their returns	37
Conclusion	40

Table of Authorities Cited

Cases	Pages
Axton v. Commissioner, 32 B.T.A. 612.....	33
Coddon, L. D., & Bros. Inc. v. Commissioner, 37 B.T.A. 393	25
Commissioner v. Bonwit Teller & Co., 87 Fed. (2d) 764....	37
Dallas Transfer and Terminal Warehouse Co. v. Commis- sioner, 70 Fed. (2d) 95.....	14, 25, 31
Edwards v. Grand, 121 Cal. 254.....	39
Lakeland Grocery Co. v. Commissioner, 36 B.T.A. 289....	25, 26, 29, 30
Madison Railway Company v. Commissioner, 36 B.T.A. 1106	15, 26, 30
Perkins v. Commissioner, 33 B.T.A. 606.....	39
Springfield Industrial Building Company, The, v. Commis- sioner, 38 B.T.A. 1445.....	25, 30
State National Bank v. Lowenstein, 155 Pac. 1127.....	39
U. S. v. Kirby Lumber Co., 284 U. S. 1.....	14
U. S. v. Ludey, 274 U. S. 295.....	24
U. S. v. Supplee Biddle Hardware Co., 265 U. S. 189, 196..	24
Walker v. Commissioner, 88 Fed. (2d) 170.....	17

Miscellaneous

Magill on Taxable Income, Chapt. 7.....	14
Paul & Mertens, Sec. 18.112.....	36

No. 10,087

IN THE
United States Circuit Court of Appeals
For the Ninth Circuit

MINNIE L. WHITTHORNE and EVA WHIT-
THORNE, Executrices of the Estate of
W. R. Whitthorne, Deceased,

Petitioners,

VS.

COMMISSIONER OF INTERNAL REVENUE,

Respondent,

and

SHERWOOD SWAN,

Petitioner,

VS.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

OPENING BRIEF OF PETITIONERS=APPELLANTS.

The above entitled cases were consolidated for trial before the Board of Tax Appeals and consolidated for appeal before this Court inasmuch as they involved identical issues arising out of the same state of facts.

The Sherwood Swan case involves a proposed additional tax of \$43,381.44 for 1936 and a penalty for delinquent filing of \$2,242.74 and the Whitthorne case

involves a proposed additional tax for 1936 of \$9,812.45 and a penalty for delinquent filing of \$495.12. Shortly before the trial Whitthorne died and the executrices of his estate were substituted as parties petitioner.

STATEMENT OF FACTS.

In 1930 and for some time prior thereto Sherwood Swan and W. R. Whitthorne had been associated together in business activities of a mercantile nature in the City of Oakland. They were in March, 1930 and for some time had been the owners (one-half each) of 1,000 shares of the capital stock of Sherwood Swan and Company, Ltd., being all the issued capital stock of that company. Sherwood Swan and Company, Ltd. operated a market in the City of Oakland commonly known as the Tenth Street Market. (Findings Tr. p. 78.)

Messrs. Swan and Whitthorne were in March 1930 and for some time had been indebted in amounts far in excess of their assets as follows:

A. To Harrison S. Robinson for money loaned to them in the sum of \$35,000 represented by their joint and several promissory note secured by their pledge of said 1,000 shares of the stock of Sherwood Swan and Company, Ltd.

B. To Central National Bank of Oakland for money loaned to them as follows:

	<u>Swan</u>	<u>Joint and Several</u>	<u>Total</u>
Unsecured	\$20,000		
Secured by the pledge of 6,000 shares of Hale Bros. Stores, Inc.		\$250,000	\$270,000

C. To Bank of America for moneys loaned to them
as follows:

	<u>Swan</u>	<u>Joint and Several</u>	<u>Total</u>
Unsecured	\$65,000		
Secured by the pledge of 2171 shares of Hale Bros. Realty Co.		\$100,000	
Secured by a mortgage on a ranch in Madera County having a value of approximately \$6,000	\$10,000		\$175,000

D. To Davis S. Wasserman \$100,000, balance of
purchase price of Wasserman-Gattmann business se-
cured by the pledge of 1,000 shares of Wasserman-
Gattman Co. (Findings Tr. p. 78.)

In March, 1930, Swan's assets consisted of the
following items:

(i) An account receivable due from Wasser-
man-Gattmann Co. in the amount of \$2,425.55;

(ii) 500 shares of Sherwood, Swan and Com-
pany, Ltd.;

(iii) 2,071 shares of Hale Bros Realty Co.;

(iv) 1,725 shares of Wasserman-Gattmann Co.;

(v) 2,000 shares of Swan's (a corporation);
and

(vi) A ranch situated in Madera County, California.

(Tr. p. 42; Swan Petition V-1.)

Petitioner Whitthorne's assets on that date consisted of the following items:

(i) An account receivable due from Sherwood Swan and Company, Ltd., in the amount of \$5,506.09;

(ii) 500 shares of Sherwood Swan and Company, Ltd.;

(iii) 6,000 shares of Hale Bros. Stores, Inc.;

(iv) 1,725 shares of Wasserman-Gattmann Co.; and

(v) 2,000 shares of Swan's (a corporation).

(Tr. p. 10; Whitthorne Petition V-1.)

Steps were taken whereby the banks (Central National Bank and Bank of America) caused to be paid to Harrison S. Robinson the \$35,000 principal and accrued interest on the note due to him from Sherwood Swan and W. R. Whitthorne. Thereupon the 1000 shares of stock of Sherwood Swan and Company, Ltd. theretofore pledged to Harrison S. Robinson were released and were pledged 500 shares to the Central National Bank of Oakland and 500 shares to Bank of America. (Findings Tr. p. 78; Testimony of Robinson, Tr. p. 108.)

At the time of such pledging, to-wit, in March, 1930, at a meeting at which there were present Sherwood Swan, Harrison S. Robinson, his attorney, Oscar

L. Cox, Vice President of Bank of America, J. W. Carlston, President of Central National Bank, and James A. Wainwright, Vice President of the Central National Bank, it was agreed on behalf of each bank by its responsible officers that if said Sherwood Swan and W. R. Whitthorne should reimburse the banks for the \$35,000 and interest advanced by the banks to pay off Mr. Robinson and should at any time pay to each bank the sum of \$100,000 on account of their obligations to such bank, the two lots of 500 shares each of stock of Sherwood Swan and Company would be released from pledge and would be freed from further pursuit in any form by such banks on account of the obligations of Sherwood Swan and W. R. Whitthorne to the banks. The banks were subsequently reimbursed for the \$35,000 and interest so advanced by them to pay to Robinson. (Findings Tr. pp. 78-9; Testimony of Robinson, Tr. pp. 108-9.)

This agreement was confirmed by letters from the banks' officers. (Tr. pp. 185-201; Petitioners' Ex. 1-8, inc.)

Sherwood Swan and W. R. Whitthorne were not able to make the required payments to secure the release of their Sherwood Swan and Company (commonly known as the Tenth Street Market) stock until December 16, 1936. In that month the following transactions took place:

1. Sherwood Swan and W. R. Whitthorne borrowed from the Anglo California National Bank the sum of \$175,000.

2. Bank of America caused to be conducted a pledgee's sale of the pledged assets in its hands and disposed of the same at such sale as follows:

a. To Sherwood Swan and W. R. Whitthorne 500 shares of the stock of Sherwood Swan and Company for \$100,000, such \$100,000 being a portion of the \$175,000 borrowed by them from The Anglo California National Bank.

b. To Bank of America the remaining assets pledged to it, to-wit, 2071 shares of stock of Hale Bros. Realty Co., 1,000 shares of Swan's, a corporation, and 1722 shares of Wasserman-Gattmann Co., a corporation, for \$96,073.14, being the balance then due from Sherwood Swan and W. R. Whitthorne to said bank (Findings Tr. pp. 79-80; Petitioners' Ex. 15; Tr. pp. 213-217.)

3. The receiver of Central National Bank, with the approval of the United States District Court, and the Comptroller of Currency received from Sherwood Swan and W. R. Whitthorne \$75,000 cash and their joint and several non-interest bearing promissory note for \$20,000, payable \$4000 per year, and in consideration thereof released to Sherwood Swan and W. R. Whitthorne from pledge 500 shares of the stock of Sherwood Swan and Company, Ltd. and discharged Sherwood Swan and W. R. Whitthorne from liability on their notes to said Central Bank. (Findings Tr. p. 79; Petitioners' Exs. 13, 14; Tr. pp. 205-213.)

4. Sherwood Swan and W. R. Whitthorne caused a corporate reorganization of Sherwood Swan and Company, Ltd. to be carried out whereby the 1,000 shares

of its capital stock heretofore referred to were cancelled and in lieu thereof there was issued to Sherwood Swan and W. R. Whitthorne 30,000 shares of Class A Preferred stock of \$10,000 par value and 45,000 shares of Common stock of no par value. (Findings Tr. pp. 81-82.)

On December 16, 1936, after the steps just recited and immediately prior to the marketing of the preferred stock referred to in the succeeding paragraph, the assets and liabilities of Swan consisted of the following items (using as a basis for valuing the Sherwood Swan and Company, Ltd. stock the selling price of its Class A stock):

ASSETS

Current assets:

Due from Sherwood Swan and Company, Ltd.	\$ 9,835.12
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Investments:

Sherwood Swan and Company, Ltd. capital stock—500 shares—fair market value (exchanged on December 16, 1936 for 15,000 Class A shares having fair market value of \$7.00 per share and 22,500 shares common stock with no market value).....	\$105,000.00
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Ranch situated in Madera County, California—held under mortgage by Bank of America (contra)—approximate market value	6,000.00	111,000.00
	<hr/>	<hr/>
		\$120,835.12
		<hr/>

LIABILITIES

Current Liabilities:

Notes payable—

Bank of America—secured by first mortgage on ranch situated in Madera County, California (contra)	\$ 10,000.00	
Central Company (one-half of joint indebtedness of Sherwood Swan and W. R. Whitthorne totaling \$20,000)	10,000.00	
Anglo California National Bank (one-half of joint indebtedness of Sherwood Swan and W. R. Whitthorne in the respective total sums of \$175,000 and \$5,000)	90,000.00	
David S. Wasserman	5,000.00	115,000.00

Accounts payable—

Helen L. Swan	4,788.00	
Charles Raphael	500.00	
Harry Camp	7,500.00	
Orrick, Palmer & Dahlquist (one-half of joint indebtedness of Sherwood Swan and W. R. Whitthorne totaling \$2,000)	1,000.00	
T. E. Louis	725.10	
R. L. Underhill	200.00	
George D. Roberts	500.00	
McKinstry, Haber & Pierce Coombs	300.00	
Moose Club	58.50	15,571.60

Accrued taxes—

Federal income taxes on 1936 income except that on sale of Sherwood Swan & Company, Ltd. stock and alleged gain on discharge of bank indebtedness	620.78	
California state income taxes on 1936 income accrued to December 16, 1936 (based upon same inclusions as federal tax)	143.57	764.35
SHERWOOD SWAN—NET INSOLVENCY ...		10,500.83
		<u>\$120,835.12</u>

(Findings Tr. p. 81; Petitioner Swan's Ex. 10; Tr. pp. 203-4.)

On December 16, 1936, immediately prior to the marketing of the preferred stock referred to in the succeeding paragraph, the assets and liabilities of Whitthorne consisted of the following items (using as a basis of valuing the Sherwood Swan and Company, Ltd. stock, the selling price of its Class A stock):

ASSETS

Investment:

Sherwood Swan and Company, Ltd.	
capital stock—500 shares—fair	
market value (exchanged on De-	
cember 16, 1936 for 15,000 Class	
A shares having fair market value	
of \$7.00 per share and 22,500	
shares common stock with no mar-	
ket value)	\$105,000.00

LIABILITIES

Current Liabilities:

Notes Payable—

Central Company (one-half of joint indebtedness of Sherwood Swan and W. R. Whitthorne totaling \$20,000)	\$10,000.00		
Anglo California National Bank (one-half of joint indebtedness of Sherwood Swan and W. R. Whitthorne in the respective total sums of \$175,000 and \$5,000)	90,000.00	100,000.00	
	<hr/>		

Accounts Payable—

Orrick, Palmer & Dahlquist (one-half of joint indebtedness of Sherwood Swan and W. R. Whitthorne totaling \$2,000)	1,000.00		
George D. Roberts	500.00	1,500.00	101,500.00
	<hr/>		

NET WORTH

\$ 3,500.00

(Findings Tr. p. 81; Testimony of Swan, Tr. pp. 141-143.)

In addition Whitthorne was contingently liable for Swan's half of the \$20,000 joint and several note to Central Company and Swan's half of the \$180,000 notes to the Anglo California National Bank. Since Swan was insolvent (see his statement of Assets and Liabilities, *supra*), these contingent liabilities may be properly considered in determining Whitthorne's solvency. Giving such consideration, they more than wipe out his net worth of \$3500.

5. Sherwood Swan and W. R. Whitthorne entered into an agreement on November 16, modified on December 16, 1936, with Robert N. Miller & Co. whereby Sherwood Swan and W. R. Whitthorne agreed to sell and Robert N. Miller & Co. agreed to buy from them \$25,000 of the Class A shares for \$7.00 per share or a total purchase price of \$175,000. This agreement and the purchase price moneys to be paid thereunder were pledged by Sherwood Swan and W. R. Whitthorne to the Anglo California National Bank to secure the payment of the \$175,000 note referred to in paragraph No. 4 above. (Finding Tr. p. 82.)

There was no sale of the old stock of Sherwood Swan and Company, Ltd. prior to the reorganization thereof on December 16, 1936. There was no sale or transfer of the common stock of Sherwood Swan and Company, Ltd. after the reorganization, except a single transaction whereby Swan acquired 4500 shares of said stock from Whitthorne in consideration of which Swan assumed Whitthorne's half of the liability under the \$20,000 non-interest bearing note executed by Swan and Whitthorne on December 16, 1936 to the Central National Bank. The value of said obligation assumed by Swan as of the date of such transfer, to-wit, May 18, 1937 was \$8618.48. (Tr. p. 221; Petitioners' Exhibit 21.) The transaction was entered into because Mr. Whitthorne as the much senior in age of the two business associates wanted Mr. Swan as the younger man to increase his holdings of the common stock from 50% to 60% which would give him substantial control of the company and Swan

wanted to assume the liability. They did not discuss values. (Findings Tr. p. 83; Testimony of Swan, Tr. pp. 145-6.)

There have never been any sales or other transfers of the common stock or any offers thereof for sale or any bids therefor. (Findings Tr. p. 83.)

The income tax returns of Swan and wife and Whitthorne and wife (consisting of formal blanks and a twelve-page memoranda setting forth in detail the various transactions of December, 1936, hereinbefore referred to) were prepared by Frank G. Short, Certified Public Accountant, partner in Barrow, Wade, Guthrie & Co. in the period between March 18, 1937 and May 29, 1937. The returns showed no tax due from either Swan or Whitthorne. Mr. Short procured an extension of time to file such returns to April 15th and a second extension of time to June 1, 1937. He worked fairly continuously on the task during that period. The returns were finished on Saturday, May 29, 1937 and delivered to Swan in San Francisco on the next business day, Tuesday, June 1, 1937. The four returns were notaried on June 1, 1937, a check for one-half the tax shown by Mrs. Swan's return to be due from her was drawn by Sherwood Swan and Company on June 1, 1937 (Test. Short, Tr. pp. 167-169), Mr. Swan took the returns on June 1 to the Internal Revenue Office in the Post Office Building, Oakland, and filed them by slipping them through the slot in the door of the Deputy Collector's office. (Test. Swan, Tr. pp. 179-180.)

**STATEMENT OF THE POINTS UPON WHICH
PETITIONERS RELY.**

I. By the March, 1930 agreement, the banks released the Sherwood Swan and Company, Ltd. stock from pursuit except to the amount of \$100,000 to each bank, thus immediately freeing that stock from all demands in excess of \$200,000, and thus any gain occasioned by such freeing of assets took place in 1930.

II. Any income to petitioners incident to the freeing of assets occasioned by the cancellation of indebtedness cannot exceed the cost basis of such assets to taxpayer.

III. Using cost as the proper valuation of the assets freed, petitioners did not receive any taxable income incident to the freeing of such assets by the cancellation of indebtedness.

IV. Any income to petitioners incident to the release of assets occasioned by the cancellation of indebtedness cannot exceed the net fair market value of the assets so released.

V. Using the fair market value basis, petitioners did not receive any taxable income incident to the freeing of assets by the cancellation of indebtedness.

VI. The entire cost to petitioners of the Sherwood Swan and Company stock should be applied as the basis for the Class A preferred stock sold by them rather than simply an allocated percentage thereof.

VII. There was reasonable cause for the apparent one-day delay of petitioners in the filing of their returns.

ARGUMENT.

- I. BY THE MARCH, 1930 AGREEMENT, THE BANKS RELEASED THE SHERWOOD SWAN AND COMPANY, LTD. STOCK FROM PURSUIT EXCEPT TO THE AMOUNT OF \$100,000 TO EACH BANK, THUS IMMEDIATELY FREEING THAT STOCK FROM ALL DEMANDS IN EXCESS OF \$200,000, AND THUS ANY GAIN OCCASIONED BY SUCH FREEING OF ASSETS TOOK PLACE IN 1930.

Three of the points which will be argued in this brief deal with the so-called "cancellation of indebtedness" rule. Hence, it will be necessary to enter into a preliminary discussion of that rule and of the basis for it.

A great deal of confusion has been occasioned by the unqualified statement sometimes made that income accrues to the debtor from the cancellation of his indebtedness. Cancellation of indebtedness does not *per se* constitute income to the debtor. The income arises rather from the freeing of assets in the hands of the debtor which previously were subject to the claims of the creditors, but which by the settlement or cancellation are now freed therefrom.

The true theory upon which the rule is based is well explained by Professor Magill in Chapter 7 of his work on *Taxable Income*, beginning on page 226.

In *Dallas Transfer and Terminal Warehouse Co. v. Commissioner* (C. C. A. 5), 70 Fed. (2d) 95, the Court spoke of the situation before it as one where:

"There is a reduction or extinguishment of liabilities without any increase of assets."

The Court thus distinguished *U. S. v. Kirby Lumber Co.*, 284 U. S. 1:

“The decision that the increase in clear assets so brought about constituted taxable income is not applicable to the facts of the instant case, as the cancellation of the respondent’s past due debt to its lessor did not have the effect of making the respondent’s assets greater than they were before that transaction occurred. Taxable income is not acquired by a transaction which does not result in the taxpayer getting or having anything he did not have before.”

The necessity for there being a freeing of assets from the claims of creditors was emphasized by the Board in *Madison Railways Company v. Commissioner*, 36 B. T. A. 1106, where the Board said:

“If in this proceeding the purchase and retirement of the petitioner’s bonds at less than the issuing price had resulted in making the petitioner solvent, we would have been constrained to hold that the petitioner had derived taxable income from the transaction, at least to the extent that its assets were freed from claims of creditors.”

The rule should more properly be stated as “the release of assets” rule rather than “the cancellation of indebtedness” rule. We will have occasion hereafter to again refer to this distinction in each of the next succeeding three points.

Our first point deals with the relationship between what we will describe as the “Agreement Not to Pursue” of March, 1930 and the “Release of Indebtedness Agreement” of December, 1936.

In March, 1930, the petitioners Swan and Whitthorne were insolvent. They were indebted to Wasserman in the sum of \$100,000 for the purchase of stock in Wasserman-Gattmann Co. They were heavily indebted to two banks—to the Central National Bank in the sum of \$270,000 and to the Bank of America in the sum of \$175,000. Their only asset which would ever enable them to work out of difficulty was 1000 shares (the entire capital stock) of Sherwood Swan and Company, which operated a produce market in the City of Oakland commonly known as the “Tenth Street Market”. This stock, in March, 1930, and for some years past, had been pledged by them to Harrison S. Robinson to secure their joint note for \$35,000. The banks wanted this stock as security for their loans and accordingly arranged to and did pay Mr. Robinson off and took a pledge of the stock, 500 shares to each bank. However, at the same time the banks recognized that in order to induce Swan and Whitthorne to endeavor to work themselves out of this difficulty they must hold out to the debtors inducements that upon some agreed terms they would ultimately receive their stock in the Market freed from claims of the banks. Accordingly it was agreed by the two banks on the one hand, and Messrs. Swan and Whitthorne, on the other, in March of 1930, that when the banks should be reimbursed for the \$35,000 they paid to Mr. Robinson and should each receive the sum of \$100,000, the stock in the Tenth Street Market would be released from further pursuit by the banks. In other words, the banks would look to the

stock only for \$235,000. They were shortly reimbursed for the \$35,000, leaving the figure at \$200,000.

It is not our contention that the March, 1930, agreement itself constituted a complete cancellation of the indebtedness. Hence, *Walker v. Commissioner*, 88 Fed. (2d) 170, is not in point.

But we do contend that the March, 1930 agreement did have a very real effect in determining from what debts the Tenth Street Market stock was freed. All that the *Walker* case decided was that the date of the cancellation of indebtedness, or to put it the other way, the date of the freeing of the stock was the date of consummation of the transaction and not the date the contract was made. That is not the problem here.

What we contend is that while the March, 1930, agreement did not itself constitute a complete cancellation of any indebtedness so far as the *personal liability* of Messrs. Swan and Whitthorne was concerned, it did constitute an agreement that this particular asset—the stock of Sherwood Swan and Company—would not be pursued for anything in excess of \$200,000—\$100,000 to each of the two banks.

We come then to what transpired in December, 1936. The Receiver for the Central National Bank upon receipt of \$95,000 (\$75,000 cash and a \$20,000 note) released its 500 shares to Messrs. Swan and Whitthorne and cancelled all their notes. So far as the *personal responsibility* of Swan and Whitthorne was concerned, this constituted a release of all their old indebtedness to the Receiver of that bank. But

so far as the *stock* was concerned, it had already been freed from pursuit as to all indebtedness except \$100,000. Thus by this transaction it was only freed from \$5000 of indebtedness—the difference between \$100,000 agreed upon and the \$95,000 paid.

So far as the Bank of America is concerned, on December 16, 1936, it sold the Tenth Street Market stock to Messrs. Swan and Whitthorne at pledgee's sale for \$100,000 and sold to itself the remaining assets pledged to it at pledgee's sale for an amount equivalent to the balance of the indebtedness from Swan and Whitthorne—\$96,073.14.

Under the evidence this did not constitute a cancellation of indebtedness at all; for the bank by its own voluntary act simply acquired the Hale Bros. Realty Co., Swan's and Wasserman-Gattmann Co. stock at pledgee's sale for \$96,073.14. It could have cancelled the remaining indebtedness as the Central Bank did, but it elected to purchase the miscellaneous assets for the full balance of its indebtedness, thus leaving nothing to be cancelled. The method in which Bank of America elected to handle the transaction may have resulted in capital gain or loss, depending on the cost of these miscellaneous assets to Swan and Whitthorne, but it certainly did not result in a cancellation of indebtedness, for the bank realized its entire indebtedness by the two parts of the pledgee sale.

However, even if the transaction could be construed to be a cancellation of indebtedness, the Sherwood Swan and Company, Ltd. stock, by the Bank of

America's March, 1930 agreement, had been freed from pursuit except as to the \$100,000 agreed to be paid and which was so paid.

The Board of Tax Appeals in the present case confuses the factor in the transaction which is the real benefit to the taxpayer and which results in income to him. We quote the pertinent portion of the opinion of the Board with our comment thereon.

Opinion.

The petitioners argue a new conception of the doctrine of realization of income in connection with a debt settlement.

They say the essence of the realization is not the settlement of the debts alone, but the freeing of assets, and that such freeing of assets occurred in 1930 when the pledge of the shares was limited by the banks to \$100,000.

A solvent taxpayer realizes a gain by a reduction of his debt irrespective of whether the debt is secured by a pledge or mortgage.

Comment.

The conception is not "new". As we have shown just above, it has always been present in the authorities.

Correct, and thereafter the taxpayer was free to use these assets in his operations, subject only to the burden of \$100,000 thereon to each bank. If the banks in 1930 by agreement had *completely* released the market stock from pursuit, then the taxpayers would have had the entire value of such assets to use in their future operations, and thereby would have received income to the extent of such asset so freed. They did receive in 1930 the freedom to use a portion of such value, to-wit, the equity therein in excess of \$200,000.

This statement is correct to the extent that the rule is not limited to the situation where there is a formal pledge or mortgage, but, nevertheless,

Opinion.

The freeing of assets which has been regarded in the decisions as a significant fact is not the release of the pledged security from lien, but the effect of enabling the debtor to use all his assets freed from the incubus of the debt.

The obliteration of the offsetting liability for debt is what constitutes the gain.

If in 1930 the creditor banks had not only agreed to limit the use of the pledged shares security for \$100,000 of the debt, but had also renounced

Comment.

there must be assets freed by the transaction from the burden, even though such burden is not a secured one. It is only the newly freed assets which constitute income.

The Board here recognizes that it is the enabling of the debtor to use his assets freed from the incubus of the debt which is the significant fact. However, the Board is in error in referring to the transaction as merely "the release of the pledged security from lien"; here there was much more. There was an agreement not to pursue at all for more than a fixed sum.

This contradicts the preceding sentence. We submit that it is not the obliteration of the offsetting debt liability, but the freeing of assets. For example: If a taxpayer had no assets and his creditors cancelled a part or all of his liabilities, that would not constitute taxable income. That is why the Courts and the Board itself have refused to find any taxable gain where the recipient of the cancellation is insolvent.

This can be answered by a simple illustration. Suppose a taxpayer has \$300,000 of assets and \$300,000 of liabilities. In 1930 the creditor releases

Opinion.

all claim on the debtor for more than \$100,000, the forgiveness would have been a gain, not because the lien was limited, but because the excess amount of the debt was discharged without payment. Having been realized in 1930 it would have been taxable then and not later. But it was not until 1936 that the debt was finally settled; so the resulting gain is properly taxable then.

Comment.

\$200,000 of the assets from all pursuit on his debt. In 1936 the creditor releases the remaining \$100,000 of assets from pursuit on the debt. Clearly the taxpayer did not receive his entire benefit in 1936. He benefited to the extent of \$200,000, the value of his assets then available to him, in 1930, and he benefited in 1936 to the value of the remaining \$100,000 of assets then freed to him. That was the situation here of Whitthorne and Swan. They benefited in 1930 to the extent of the equity in the market stock above \$200,000. The only assets which were released to them in 1930 were the comparatively small other assets then owned by them—in Swan's case \$9000, and in Whitthorne's, none.

The only way in which a transaction of this character can result in income to the debtor is not by the cancellation of indebtedness, but by the freeing of his assets from the claims of creditors. We have proved that both lots of Sherwood Swan and Company stock were freed in 1930 from all claims in excess of \$100,000 each. There being no freeing of assets from claims in 1936, there was no income in that year, except that the Central Bank accepted \$95,000 instead of the \$100,000 agreed upon.

II. ANY INCOME TO PETITIONERS INCIDENT TO THE RELEASE OF ASSETS OCCASIONED BY THE CANCELLATION OF INDEBTEDNESS CANNOT EXCEED THE COST BASIS OF SUCH ASSETS TO PETITIONERS.

The Board of Tax Appeals, thinking only of its "cancellation of indebtedness" theory, treats the entire amount of the indebtedness to the banks in excess of the \$195,000 paid to them as income. But as we have pointed out above, the significant fact is not the amount of *indebtedness cancelled* but the amount of *assets freed* from the claims of such indebtedness. What then is the amount of the assets so "freed"? Clearly the taxpayer cannot be deemed to have received income in excess of the cost or other basis to him of the stock so freed.

It is stipulated that the cost of the Sherwood Swan and Company, Ltd. stock to Messrs. Swan and Whitthorne was \$100,000—\$50,000 to each. Therefore, the maximum amount which it can be contended Mr. Swan was enriched by freeing this stock to him is \$50,000 instead of the \$80,009.13 figure used by the Commissioner. This latter figure is the Commissioner's computation of the amount of the cancelled indebtedness, but since such cancelled indebtedness is in excess of the basis of the stock freed, such basis constitutes the maximum amount of Mr. Swan's income on the transaction.

There are two reasons why such cost basis must constitute the maximum amount of income which the taxpayer can be deemed to receive incident to such a transaction:

(a) **The income tax statute deals only with realized gains.**

Any purported gain which it might be contended the taxpayer received by the transaction in excess of cost would be an unrealized gain.

Assume by way of illustration that this stock originally cost Mr. Swan \$50,000; that its fair market value at the date of the cancellation of indebtedness in 1936 had risen to \$100,000, but that subsequently, when Mr. Swan disposes of it, it has shrunk to \$75,000. Clearly, there would be no realization of any \$50,000 increment in value between the date Mr. Swan acquired the stock and 1936 when it was freed from the burden of the indebtedness by the cancellation. There was a temporary increment in value in the illustration just used, but that increment had nothing to do with the cancellation transaction any more than the shrinkage in value which we assume in the illustration as occurring subsequently.

The argument we are making, which is given point by the illustration just used, is that the only theory under which taxable income can be deemed to have accrued by reason of the transaction is that the asset long owned, but until now by reason of the creditor's claim not free for use, is now free. So all that the taxpayer has received is the freedom to use the asset which he has always owned and such asset should be treated in his hands for income computation purposes at its cost basis.

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The argument we are making, which is given point by the illustration just used, is that the only theory under which taxable income can be deemed to have accrued by reason of the transaction is that the asset long owned, but until now by reason of the creditor's claim not free for use, is now free. So all that the taxpayer has received is the freedom to use the asset which he has always owned and such asset should be treated in his hands for income computation purposes at its cost basis.

- (b) To use any value greater than cost as the basis for computing the profit on the release of assets would result in double taxation.

The income tax statute does not specifically forbid double taxation. Nevertheless, it has been frequently held that equity will so construe the act as to prevent double taxation where possible, and that double taxation is not permitted to be imposed against a single taxpayer arising out of a single transaction.

U. S. v. Supplee Biddle Hardware Co., 265 U. S. 189, at page 196.

In *U. S. v. Ludey*, 274 U. S. 295, at page 301, it was held that the act would be construed as not to permit a double deduction for the loss of the same capital asset. Similarly, the act should be so construed as not to permit a double taxation upon the same increment in value.

The rule is well illustrated by the two steps which the Commissioner has attempted to take here:

1. Under his "cancellation of indebtedness" theory, the Commissioner is requiring Mr. Swan to pay a tax on a gain of \$80,009.13 with respect to property that cost him \$50,000.

2. In computing the gain on the sale of this stock by Mr. Swan on the same day, the Commissioner uses not the \$170,009.13 minus \$50,000.00, or \$80,009.13 figure, upon the basis of which he computed the gain in the first step, but he goes back to the original \$50,000 and uses an allocated portion of that, to-wit, 84% of \$50,000.

Clearly, if there was a realization of income incident to the freeing of the stock from the claims of the banks to such an extent that income may be computed, not on the cost but on the increased fair market value thereof, then it is the worst form of double taxation to again tax that same increase in value when the stock is on the same date sold. We submit that the maximum value which can be given to such stock in computing the profit on its being freed from the claims of creditors is its cost basis in the hands of the taxpayer. This leaves that same cost then as the appropriate basis to use in computing the profit on the sale of the stock, thus avoiding the double taxation of the same increment in value.

There are no cases decided by either the Board or the Courts in which any valuation in *excess of cost* has been used in computing income on such a release of assets. In the *Lakeland Grocery Co. v. Commissioner* case, 36 B. T. A. 289, the market value was less than the book value. In *L. D. Coddon & Bros. Inc. v. Commissioner*, 37 B. T. A. 393, *The Springfield Industrial Building Company v. Commissioner*, 38 B. T. A. 1445 and *Dallas Transfer and Terminal Warehouse Co. v. Commissioner*, 70 Fed. (2d) 95, the property having depreciated in value, the Board or Court used such depreciated value resulting in a figure less than cost. But in no case has the income as the result of such a transaction been computed at a valuation in excess of book value or cost.

III. USING COST AS THE PROPER VALUATION OF THE ASSETS FREED, PETITIONERS DID NOT RECEIVE ANY TAXABLE INCOME INCIDENT TO THE RELEASE OF SUCH ASSETS AND THE CANCELLATION OF INDEBTEDNESS.

The authorities are clear that a taxpayer will receive taxable income incident to a cancellation of indebtedness and release of assets only if he is *solvent* after the cancellation.

Lakeland Grocery Co. v. Commissioner, 36 B. T. A. 289;

Madison Railways Company v. Commissioner, 36 B. T. A. 1106.

Using cost figures as a basis, the taxpayers were *insolvent* after the cancellation of indebtedness as well as before.

MR. SWAN

ASSETS

Current Assets:

Due from Sherwood Swan and Company, Ltd.	\$ 9,835.12
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Investments:

500 shares Sherwood Swan and Company Ltd. stock at cost.....	\$ 50,000.00	
Madera County Ranch	10,000.00	60,000.00
		<hr/>
		\$ 69,835.12
		<hr/>

LIABILITIES

Current Liabilities:

Notes Payable—

Bank of America—secured by first mortgage on ranch situated in Madera County, California (contra)	\$ 10,000.00	
Central Company (one-half of joint indebtedness of Sherwood Swan and W. R. Whitthorne totaling \$20,000)	10,000.00	
Anglo California National Bank (one-half of joint indebtedness of Sherwood Swan and W. R. Whitthorne in the respective total sums of \$175,000 and \$5,000)....	90,000.00	
David S. Wasserman	5,000.00	\$115,000.00

Accounts Payable—

Helen L. Swan	4,788.00	
Charles Raphael	500.00	
Harry Camp	7,500.00	
Orrick, Palmer & Dahlquist (one-half of joint indebtedness of Sherwood Swan and W. R. Whitthorne totaling \$2,000)	1,000.00	
T. E. Louis	725.10	
R. L. Underhill	200.00	
George D. Roberts	500.00	
McKinstry, Haber & Pierce Coombs	300.00	
Moose Club	58.50	15,571.60

Accrued taxes—

Federal income taxes on 1936 income except that on sale of Sherwood Swan and Company, Ltd. stock and alleged gain on discharge of bank indebtedness....	620.78	
California state income taxes on 1936 income accrued to December 16, 1936 (based upon same inclusions as federal tax).....	143.57	764.35

Sherwood Swan—Net Insolvency		61,500.83
		<u>\$ 69,835.12</u>

MR. WHITTHORNE

ASSETS

Investment:

Sherwood Swan and Company, Ltd. capital stock—500 shares—at cost..	\$ 50,000.00
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LIABILITIES

Current Liabilities:

Notes Payable—

Central Company (one-half of joint indebtedness of Sherwood Swan and W. R. Whitthorne totalling \$20,000)	\$ 10,000.00	
Anglo California National Bank (one-half of joint indebtedness of Sherwood Swan and W. R. Whitthorne in the respective total sums of \$175,000 and \$5,000)	90,000.00	100,000.00

Accounts Payable—

Orrick, Palmer & Dahlquist (one-half of joint indebtedness of Sherwood Swan and W. R. Whitthorne totalling \$2,000)	1,000.00	
George D. Roberts	500.00	1,500.00

W. R. WHITTHORNE—NET INSOLVENCY...	51,500.00
	<u>\$50,000.00</u>

Since the taxpayers were thus insolvent after the transaction, they received no taxable income by reason of the cancellation of indebtedness.

IV. ANY INCOME TO PETITIONERS INCIDENT TO THE RELEASE OF ASSETS OCCASIONED BY THE CANCELLATION OF INDEBTEDNESS CANNOT EXCEED THE NET FAIR MARKET VALUE OF THE ASSETS SO RELEASED.

We have demonstrated under point II that the cost to taxpayers of the Sherwood Swan and Company stock is the maximum amount which may be used in determining whether or not the taxpayers received any income incident to the cancellation of indebtedness and freeing of assets, and we have shown under point III that applying this rule the taxpayers did not receive any taxable income incident to the transaction. But even if we depart from this cost basis and consider the fair market value of the asset at the time of the cancellation, still the taxpayers did not receive any income. The Commissioner has entirely ignored any consideration of the valuation of the assets freed and has computed his alleged profit on the full amount of the cancelled indebtedness—\$80,009.13 in the case of Swan, and \$35,040.66 in the case of Whitthorne.

We propose to show that the maximum amount which he may use is the net fair market value of the freed assets in the hands of the taxpayer on December 16, 1936 after deducting his continuing indebtedness.

In the *Lakeland Grocery Co. v. Commissioner* case, 36 B. T. A. 289, the Board, without any particular discussion of whether the test should be cost or present fair market value, determined solvency and the amount of the profit realized on the basis of book value of assets and computed a profit of \$39,596.93 on

that basis. However, we are advised by Mr. Robert Ash, attorney for the taxpayer in the *Lakeland Grocery Co.* case that his evidence before the Board showed the fair market value of the assets at the time of the transaction to be much less than book value and that rather than face an appeal the Commissioner settled for \$1000 tax instead of the \$7000 tax determined by the Board.

In all cases since the *Lakeland Grocery Company* case where there has been a shrinkage in the value of assets the Board has used the fair market value at the time of the transaction rather than the larger book value.

Madison Railway Company v. Commissioner, 36 B. T. A. 1106. The taxpayer had among its assets street railways of the book value of \$452,829.53, but which it was admitted had no real value in the tax years in question. The Board, in determining that the taxpayer was insolvent after the cancellation of indebtedness and therefore not subject to tax, took into consideration not the book value of the assets but the lesser fair market value obtained by eliminating this item from the assets.

Again in *The Springfield Industrial Building Company v. Commissioner*, 38 B. T. A. 1445, the Board in determining the insolvency of the taxpayer at the time of a settlement took into consideration the then reduced fair market value of real estate based upon the testimony of expert witnesses; that is to say, real estate which cost \$110,500 was valued at only \$70,000.

Using such reduced valuation the taxpayer was found to be insolvent.

Finally in *Dallas Transfer and Terminal Warehouse Co. v. Commissioner*, 70 Fed. (2d) 95 (5th C. C. A.), it was again the reduced fair market value of real estate assets to which the Court gave consideration.

We will proceed to ascertain the fair market value of Sherwood Swan and Company stock immediately after the settlement, and using such valuation, will determine the solvency of the taxpayers.

V. USING THE FAIR MARKET VALUE BASIS PETITIONERS DID NOT RECEIVE ANY TAXABLE INCOME INCIDENT TO THE RELEASE OF ASSETS FOR THE CANCELLATION OF INDEBTEDNESS.

MR. SWAN.

It can be shown that the market value of the Sherwood Swan and Company, Ltd. stock is evidenced solely by the \$7 per share price at which the A stock was sold to the brokers. On this basis Mr. Swan had a net insolvency after the transaction of \$10,500.83. See the table in statement of facts above, pages 7-8. We assign no market value to the Class B stock for the reasons set forth in Section VI of this brief, post.

MR. WHITTHORNE.

In Mr. Whitthorne's case also the market value of the Sherwood Swan and Company, Ltd. stock is evi-

denced solely by the \$7 per share price at which the A stock was sold to the brokers. Under this assumption Mr. Whitthorne had a net solvency of \$3500. However, as we demonstrated under point II, the *maximum valuation* which may be placed upon property freed from creditors' claims is the *cost basis* thereof. *Fair market value* is to be taken into consideration only in the event that it is less than cost. Under Section III, supra, we showed that using the cost basis Whitthorne was insolvent.

VI. THE ENTIRE COST TO PETITIONERS OF THE SHERWOOD SWAN AND COMPANY STOCK SHOULD BE APPLIED AS THE BASIS FOR THE CLASS A PREFERRED STOCK SOLD BY THEM RATHER THAN SIMPLY AN ALLOCATED PERCENTAGE THEREOF.

As of December 16, 1936, there was a reorganization and recapitalization of Sherwood Swan and Company, Ltd. as the result of which the 1000 shares of its capital stock theretofore owned by Messrs. Swan and Whitthorne in equal proportions were called in and there were issued to them in lieu thereof 30,000 shares of Class A preferred stock of the par value of \$10 each and 45,000 shares of no par value common stock.

Messrs. Swan and Whitthorne immediately entered into a contract of sale with brokers for the sale of 25,000 shares of the Class A preferred stock at \$7 per share. They still own the remaining 5,000 shares—2,500 shares each.

There have been no sales of the 45,000 common stock and no offers or bids therefor. The only transaction

involving this stock was that in the spring of 1937 Mr. Whitthorne transferred 10% thereof or 4,500 shares of his one-half thereof to Mr. Swan in consideration of Mr. Swan assuming the full liability (that is, Mr. Whitthorne's as well as his own) on the balance of a \$20,000 note to the Receiver of the Central Bank. This was not an "arm's-length" transaction. Witness Murphy computed the then present value of this liability at \$8,618.48. (Exhibit 21.)

Under this state of facts this common stock had no fair market value as of December, 1936.

Clearly, the transaction above referred to between Messrs. Whitthorne and Swan was not a "market" transaction. It was not at arm's length. There were no other sales or offers or bids for the common stock. Since the common stock had no fair market value, the entire cost basis of the old stock should be assigned to the Class A preferred stock.

Axton v. Commissioner, 32 B.T.A. 613, is directly in point in this connection. The facts are almost identical. Petitioners owned old common stock. They received in exchange new Class A and Class B stock, retaining the Class B and selling the Class A to brokers. This sale of the Class A stock in the *Axton* case, as in the present one, had been prearranged as a part of the whole plan. In determining the profit to the petitioners on the sale of their Class A stock the Commissioner declined to assign all the cost of their old stock to the Class A and determined that \$20.00 of such cost should be assigned to the Class B and only the balance thereof to the Class A. The Board reversed, saying:

“We find as a fact from a consideration of all of the evidence in this case that the class B stock had no fair market value and had no value, at the time it was received by these petitioners, on which a practicable allocation of the basis of the old shares could be made.

The above finding of fact for all practical purposes determines the real issue in the case. It will enable the parties to compute the tax liability of each petitioner under Rule 50. The fair market value of the Class A shares at the time received is clearly shown and is conceded to have been the price at which they were immediately sold. The gain which the petitioners realized upon the receipt of the Class A and Class B stock is the excess of the fair market value of the Class A stock over the basis of the old shares surrendered in the exchange. If that was a transaction from which no gain or loss was recognized for tax purposes, then the petitioners realized a gain from the subsequent sale of the Class A shares equal to the excess of the cash received over the basis of the old shares. Thus, no matter which gain is recognized, the amount of gain is exactly the same.

Not only is there no evidence to support the Commissioner's determination of a fair market value of \$20 a share for the class B stock at the time it was received by these petitioners, but the evidence clearly shows that determination to have been erroneous. In order to hold that the Class B stock had no fair market value upon which a profit could be computed and no value upon which a practicable allocation of the old basis could be made, it is not necessary to believe that the class B stock was worthless. If anything is ever

realized from the disposition of it, the entire amount realized will be income to these petitioners. Cf. art. 58, Regulations 74. The class B stock in question probably had some value. It was all held by a small group of individuals who had been connected with the old corporation and who were expected to continue with the new corporation. None of this stock was bought or sold until long after the date in question, when conditions had materially changed. If the assets of the corporation could have been liquidated at their book value, about \$8 would have been paid on each share of Class B stock. About 16 cents per share per year would be available for dividends on this class of stock if average earnings of the past were maintained. This stock had exclusive voting privileges so long as dividends on the other stock were not far in default. The parties agree that if a certain broker had been present to testify, he would have said he was familiar with the fair market value of the class B stock of the new corporation and that in his opinion it had a fair market value in 1928 in excess of \$15 a share. There is some other evidence from which the respondent might argue that this stock had some fair market value. On the other hand, however, there is the fact that none of it was sold; there was strong probability that the large earnings of 1927 would not be repeated; before any dividends would be available to the Class B stockholders, earnings had to be used to pay \$60,000 as dividends on preferred stock, to pay \$160,000 as dividends on Class A stock and to set aside \$50,000 annually as a sinking fund; several officers of the corporation testified that in their opinion the class B stock had no fair market value at the

time it was received by these petitioners; and there is other evidence to show that whatever small value the class B stock had in 1928 was most uncertain and highly speculative. The respondent sought witnesses to testify that the stock had a fair market value. Two of these witnesses, when called, failed to express an opinion that the stock had any fair market value. Consideration has been given to all of the evidence and it indicates with reasonable certainty that no figure can be satisfactorily fixed upon to represent the value of the class B stock at the time it was received by these petitioners. Under such circumstances the entire old basis should be recovered out of the proceeds and the excess taxes as income as received."

In commenting on this case in a supplement to their work on the Law of Federal Income Taxation, Paul & Mertens say in Section 18.112:

"Where several classes of stock are received in exchange, and stock of one class has no fair market value or no value on which a practical allocation of the basis of the old shares may be made, the entire old basis may be allocated to securities of the other class.

"The conclusion expressed in the text was reached by the Board, notwithstanding that the securities in question had a book value of about \$8.00 per share, and had exclusive voting privileges; there was also some evidence to the effect that the stock was worth \$15.00 per share. As a statement of general principles the finding of the Board in this case seems sound. In case of doubt as to the value of the several classes of securities received, it seems desirable to apply the entire

cost against the securities which have a definite market value, particularly where those securities are the first sold. In such a case the government is not apt to be substantially injured because the net result is merely a postponement of the tax."

Similarly in the case now before the Court for consideration, the entire cost of the old basis should have been used as the basis in computing the profit on the sale of the A stock to the brokers. The Board of Tax Appeals made no finding on this issue. It referred to it in paragraph 2 of its opinion, but that of course is not a substitute for a finding of fact. *Commissioner v. Bonwit Teller & Co.*, 87 Fed. (2d) 764.

VII. THERE WAS REASONABLE CAUSE FOR THE APPARENT ONE-DAY DELAY OF PETITIONERS IN THE FILING OF THEIR RETURNS.

The Commissioner assessed a 5% penalty against the taxpayers, contending that they were negligent in filing their tax returns for the year 1936 one day late.

The commissioner had by two extension of time extended the time to file the returns to June 1, 1937.

The only evidence introduced by the Commissioner was the introduction in evidence of the filed return of taxpayer Swan (Respondent's Exhibit B) which shows the Collector's Stamp—"June 2nd, 1937". The Commissioner did not introduce any supporting evidence as to the significance of this date stamp;—that is as to whether he contends that it marked the date on which the return was filed with the collector. There

is no showing as to whether it was placed on the return by the deputy collector in Oakland where it was filed or whether it was subsequently placed thereon in the collector's main office in San Francisco to which it was subsequently transmitted.

We respectfully submit that the Court should grant taxpayers relief from this penalty based on the following facts testified to by Messrs. Short and Swan. The returns which involved the statement of the various issues which have been heretofore discussed were worked on by Mr. Short (Mr. Swan's accountant) for many weeks. In the course of such work he prepared a twelve-page memorandum setting forth the history of the dealings in the stock of Sherwood Swan and Company, Ltd., a copy of which was attached to each of the four returns. The returns showed no tax due from Mr. Swan or Mr. Whitthorne and a comparatively small tax due from their respective wives. The returns were delivered to Mr. Swan on June 1st—the last date. He had them notaried and late in the afternoon had his company draw a check in payment of the first half of Mrs. Swan's tax and went to the office of the Collector of Internal Revenue in the Oakland Post Office. He did not realize that the office closed as early as 4:00 o'clock, believing it was open until 5 o'clock. Not being able to enter the office, he deposited the returns by slipping them through the mail slot in the office door. All this took place on June first. The Commissioner has not countered with any evidence as to when the collector placed his June second stamp thereon.

If Mr. Swan had mailed the returns in the Oakland Post Office Building late in the afternoon of June first addressed to the collector's office in that same building, that would have been a sufficient filing within the terms of Regulation 103, Section 19.53-4. Certainly his actual delivery of the returns to the collector's office instead of relying on the mail to deliver them for him can be no less effective.

The stamping of the return creates only a presumption that that was the date of its filing and such presumption is rebuttable by oral evidence. See *Perkins v. Commissioner*, 33 B. T. A. 606 at page 616. See also *Edwards v. Grand*, 121 Cal. 254, where the Court said:

“The contention of the appellant that, inasmuch as the mortgage was delivered to the recorder after the hour for closing the office, it cannot be deemed to have been filed for record until the hour for opening the office on the next morning, is untenable. We are cited to no authority in support of the proposition that an instrument can be properly filed only within the hours fixed by statute for keeping the office open. These hours are established for the purpose of defining a duty of the officer, and for the convenience of the public, and are not to be construed as limiting the time within which individuals may avail themselves of rights elsewhere conferred by statute.”

In *State National Bank v. Lowenstein* (Oklahoma), 155 Pac. 1127, the Court said:

“The first contention, that the date of the filing mark in such a paper is not conclusive—and that

the actual date of the delivery of the instrument to the proper custodian controls, and that such delivery may be shown by parol evidence contradicting the filing mark, is too well settled to require citation of authorities.”

We respectfully submit that Mr. Swan made an effort in good faith to file, and in fact did file, the returns on June first, and that relief should therefore be granted from the penalties.

CONCLUSION.

It is respectfully submitted that the Board of Tax Appeals should be reversed for the following reasons:

1. The 1000 shares of stock of Sherwood Swan and Company, Ltd., was freed from pursuit of the claims of the Bank creditors in 1930 for all amounts in excess of \$200,000; \$195,000 was paid to the Banks in 1936 so the only amount from which that stock was freed in 1936 was \$5000.

2. The proper basis for considering the value of the assets freed from claims of creditors in connection with a cancellation of indebtedness is the cost basis to the debtor; using such cost basis, each of these debtors was insolvent after the cancellation of indebtedness and therefore received no income as the result of such cancellation.

3. A debtor does not receive income incident to a cancellation of indebtedness and freeing of assets if, after the transaction the fair market value of his

assets is less than his continuing liabilities; using this standard each of these debtors was insolvent after the cancellation of indebtedness and therefore received no income as the result of such cancellation.

4. The common stock of Sherwood Swan and Company, Ltd., had no fair market value in December, 1936; therefore, the entire cost basis of the old Sherwood Swan and Company stock should be used as the basis of the new Class A preferred stock sold by Swan and Whitthorne in December, 1936.

5. Reasonable grounds have been shown to relieve the petitioners from penalty for one day's apparent delay in filing their returns.

Dated, Oakland, California,

July 29, 1942.

Respectfully submitted,

ROBERT W. MACDONALD,

*Attorney for Petitioners-
Appellants.*

ROBINSON, PRICE & MACDONALD,

Of Counsel.

No. 10087

**In the United States Circuit Court of Appeals
for the Ninth Circuit**

MINNIE L. WHITTHORNE AND EVA WHITTHORNE, EX-
ECUTRICES OF THE ESTATE OF W. R. WHITTHORNE,
DECEASED, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

and

SHERWOOD SWAN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISIONS OF THE UNITED
STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

SAMUEL O. CLARK, JR.,

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SEWALL KEY,

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FILED

SEP - 3 1942

PAUL M. TIERMAN,

CLERK

INDEX

	Page
Opinion below.....	1
Jurisdiction.....	1
Questions presented.....	2
Statute and regulations involved.....	2
Statement.....	2
Summary of argument.....	8
Argument:	
I. The Board correctly held that the taxpayers realized taxable gain in the taxable year from the settlement of certain debts by the payment of an amount less than the sums owed.....	10
(a) The taxpayers were solvent after the debt settlement and each had clear assets in excess of the amount of his cancelled debt.....	12
(b) The taxable gain received by the taxpayers upon settlement of their debts is measured by the amount of the debts cancelled.....	17
II. The Board properly determined the portion of the cost of the taxpayers' old stock which should be used as the cost basis of the new class A stock which they sold.....	20
III. The taxpayers are subject to a penalty for failure to file their tax returns in the time required.....	23
Conclusion.....	26
Appendix.....	27

CITATIONS

Cases:	
<i>Axton v. Commissioner</i> , 32 B. T. A. 613.....	21
<i>Baker v. Commissioner</i> , 115 F. 2d 987.....	23
<i>Collin v. Commissioner</i> , 32 F. 2d 753.....	23
<i>Commerce Trust Co. v. Woodbury</i> , 77 F. 2d 478, certiorari denied, 296 U. S. 614.....	13
<i>Commissioner v. Coastwise Transp. Corp.</i> , 71 F. 2d 104, certiorari denied, 293 U. S. 595.....	11
<i>Commissioner v. Simmons Gin Co.</i> , 43 F. 2d 327.....	11
<i>Commissioner v. Swenson</i> , 56 F. 2d 544.....	22
<i>Continental Bank v. Rock Island Ry.</i> , 294 U. S. 648.....	13
<i>Crowell v. Commissioner</i> , 62 F. 2d 51.....	23
<i>Curtiss v. Commissioner</i> , 57 F. 2d 847.....	23
<i>Dallas T. & T. Warehouse Co. v. Commissioner</i> , 70 F. 2d 95.....	11
<i>Edwards v. Grand</i> , 121 Cal. 254.....	25

Cases—Continued.

	Page
<i>Haden Co. v. Commissioner</i> , 118 F. 2d 285.....	11
<i>Helvering v. Amer. Chicle Co.</i> , 291 U. S. 426.....	10
<i>Houghton v. Commissioner</i> , 71 F. 2d 656.....	23
<i>Lakeland Grocery Co. v. Commissioner</i> , 36 B. T. A. 289.....	11
<i>Madison Railways Co. v. Commissioner</i> , 36 B. T. A. 1106.....	11
<i>McAlpine, J. K., Land & D. Co. v. Commissioner</i> , 126 F. 2d 163..	26
<i>Perkins v. Commissioner</i> , 33 B. T. A. 606.....	25
<i>Poynor v. Commissioner</i> , 81 F. 2d 521.....	25
<i>Salvage v. Commissioner</i> , 76 F. 2d 112, affirmed, 297 U. S. 106..	23
<i>Springfield Industrial Building Co. v. Commissioner</i> , 38 B. T. A. 1445.....	11
<i>United States v. Kirby Lumber Co.</i> , 284 U. S. 1.....	10
<i>United States v. Lombardo</i> , 241 U. S. 73.....	25
<i>Walker v. Commissioner</i> , 88 F. 2d 170.....	18
<i>Wells, Joseph S., Ass'n v. Helvering</i> , 71 F. 2d 977.....	16
<i>West Side Tennis Club v. Commissioner</i> , 111 F. 2d 6, certiorari denied, 311 U. S. 674.....	26
Statute:	
Revenue Act of 1936, c. 690, 49 Stat. 1648:	
Sec. 22.....	27
Sec. 53.....	27
Sec. 111.....	28
Sec. 112.....	28
Sec. 113.....	28
Sec. 291.....	29
Miscellaneous:	
Bouvier's Law Dictionary.....	25
T. D. 4871, 1938-2 Cum. Bull. 130.....	29
Treasury Regulations 94:	
Art. 22(a)-14.....	29
Art. 53-4.....	30
Art. 291-1.....	31

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ON PETITION FOR REVIEW OF THE DECISIONS OF THE UNITED
STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

OPINION BELOW

The opinion of the Board of Tax Appeals (R. 76-90)
is reported in 44 B. T. A. 1234.

JURISDICTION

This review involves income tax and penalties for the
year 1936. (R. 91-92.) The Commissioner's de-
ficiency letter to each taxpayer¹ was issued October

¹ W. R. Whitthorne, who was the original taxpayer in the case
of *Minnie L. Whitthorne v. Commissioner*, died on July 25, 1940
(R. 78), while this case was still pending before the Board and
his executrices were substituted in that case, but throughout this
brief he will be treated as the taxpayer in that case.

20, 1939 (R. 18-19, 53-54), and a petition to the Board of Tax Appeals was filed by each on January 16, 1940, which was within the period allowed by Section 272 (a) (1) of the Internal Revenue Code. This review is taken from the Board's decisions in these cases entered October 2, 1941, allowing in the case of *Whittorne v. Commissioner* a deficiency of \$6,894.28 in income tax, plus a penalty of \$344.71 (R. 91), and in the case of *Swan v. Commissioner* a deficiency of \$38,687.37 in income tax, plus a penalty of \$1,934.37 (R. 92). The petitions for review by this Court were filed on December 26, 1941 (R. 93-104), pursuant to the provisions of Section 1141 and 1142 of the Internal Revenue Code.

QUESTIONS PRESENTED

1. Whether the taxpayers realized taxable gain from the cancellation of their debts during the taxable year and if so, whether such gain should equal the amount of the debts which were cancelled.

2. Upon the non-taxable reorganization of the Sherwood Swan & Company, Ltd., the taxpayers exchanged all of the old stock for all of the new preferred and common shares. The question is whether in determining gain realized thereafter from the sale of part of the new preferred stock the cost of the old stock should be partly allocated to the new common stock, as the Board found, or should be entirely allocated to the preferred stock, as the taxpayers contend.

3. Whether the taxpayers are subject to a penalty for filing their income tax returns one day after the end of the period allowed by the Commissioner for filing such returns.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Appendix, *infra*, pp. 27-31.

STATEMENT

The pertinent facts as found by the Board of Tax Appeals are as follows (R. 78-84):

W. W. Whitthorne and Sherwood Swan (who will be referred to herein as the taxpayers) were associated in business enterprises for many years. Among these was the operation of a market in Oakland, California, through Sherwood Swan & Company, Ltd., of which each taxpayer had acquired one-half of the outstanding 1,000 shares at a cost of \$50,000 (R. 78).

In March, 1930, the taxpayers were indebted to Harrison S. Robinson on their joint and several note for \$35,000, secured by the above stock. They were indebted to David S. Wasserman on their joint purchase money note for \$100,000, secured by 1,000 shares of Wasserman-Gattmann Company, one-half being owned by each. To the Central National Bank of Oakland they owed \$250,000 on their joint and several note secured by 6,000 shares of the Hale Brothers Stores, Inc. To the Bank of America they owed \$100,000 on their joint and several note, secured by 2,071 shares of the Hale Brothers Realty Company. To the Central National Bank, Swan alone owed an unsecured debt of \$20,000; and to the Bank of America he owed an unsecured debt of \$65,000 and a debt of \$10,000 secured by a mortgage on a ranch. (R. 78.)

Pursuant to an agreement between the taxpayers and the note holders on March 12, 1930, the two banks

paid off the taxpayers' note to Robinson and were later reimbursed therefor by the taxpayers. The taxpayers' shares which were pledged to Robinson were then released, and 500 were pledged with each bank but the banks agreed not to look to the securities thus pledged for more than \$100,000 each, and it was not the intention to cancel the debts in excess of that amount. (R. 78-79.)

On December 15, 1936, the taxpayers made an agreement with the receiver for the Central National Bank, then in receivership, by which the taxpayers agreed to pay in full settlement of their debts \$75,000 in cash and to give a noninterest bearing note for \$20,000 payable in installments. At that time the total original loans on which they were jointly indebted amounted to \$165,081.32, and Swan was individually indebted for \$20,000. There was also some accrued interest due. These debts were secured by various securities, but it was found that none of these, except the 500 shares of Sherwood Swan & Company, had any value. The latter were released to the taxpayers when the settlement was approved by the court. (R. 79-80.)

On December 16, 1936, the taxpayers were indebted to the Bank of America on a joint note amounting to \$89,066.33, and Swan owed \$65,000, which debts, together with accrued interest, aggregated \$196,073.14. On that date, these debts were settled by a pledge sale at which the taxpayers bid in the 500 pledged shares of Sherwood Swan & Company for \$100,000, and the Bank of America bid in the 2,071 shares of Hale Broth-

ers Realty Company, which had also been put up as security for part of the debts, for \$96,073.14. These shares were worth \$34,564.64. (R. 80.) ²

Upon the release of the 1,000 shares of the stock of Sherwood Swan & Company, they were placed with the trust department of the Anglo-California Bank, as the taxpayers had borrowed \$175,000 on December 15, 1936, from that bank. (R. 79, 81.)

After the settlement of their debts with the Bank of America and the Central National Bank, the taxpayers' liabilities were as follows (R. 81):

	Whitthorne	Swan
Joint note to Central Company, \$20,000.....	\$10,000.00	\$10,000.00
Note to Bank of America, secured by mortgage on Swan's ranch.....		10,000.00
Joint notes to Anglo-California Bank, \$175,000 and \$5,000.....	90,000.00	90,000.00
Note due David S. Wasserman.....		5,000.00
Accounts payable.....	1,500.00	15,571.60
Unpaid taxes.....		764.35
Total.....	101,500.00	131,335.95

On the same date each owned 500 old company shares. Whitthorne owned nothing else. Swan owned in addition a claim of \$9,835.12 against the old company and the mortgaged ranch, which had a value of \$6,000.³

² The Commissioner treated the payment as equalling only the actual value of the stock and so credited the taxpayers with a payment of \$34,564.69. (R. 21-23.)

³ But the evidence also shows that Whitthorne had an income of \$35 per week (R. 156) besides dividends from his stock, which it appears amounted to \$5,500 in 1936 and may not have been included in the Board's estimate of assets. Swan also had dividends in that amount and the consolidated balance sheet of the re-organized Sherwood Company indicates that on December 31, 1936, the company owed him \$16,182.23. (R. 219.)

After the settlement of the taxpayers' indebtedness to the banks, Whitthorne's assets exceeded his liabilities by at least \$35,040.66 and Swan's assets exceeded his liabilities by at least \$80,009.13. (R. 81.)

Pursuant to the agreement with the Anglo-California Bank under which the \$175,000 loan was made, the 1,000 shares of stock were surrendered and in a tax-free exchange the Sherwood Swan Company (new company) issued therefor 30,000 class A shares with a par value of \$10 each and 45,000 common shares of no par value, representing its entire capital stock. Each taxpayer received one-half of the new shares. On November 18, 1936, the taxpayers and Robert N. Miller & Company had made a contract contemplating this reorganization in which the former agreed to purchase 25,000 class A shares for \$175,000, or at \$7 each, plus accrued dividends from December 1, 1936, to date of actual delivery; to deposit \$25,000 and securities of a value of \$35,000 with the bank as trustee as security for payment of the price; and to pay \$24,500 to the trustee within three days after the shares should be available for delivery. (R. 81-82.)

During 1936, Miller & Company deposited the collateral, paid \$87,500 during December, 1936, and received 12,500 shares. The payment of the purchase price was completed by February 9, 1937, and the remaining 12,500 shares were delivered. After final payment the trustee delivered the 2,500 class A and 22,500 common shares remaining with him to each taxpayer. There has been no sale of common shares, but in 1937 Whitthorne transferred 4,500 to Swan, who agreed to

relieve Whitthorne of liability on their joint \$20,000 note due the Central National Bank. (R. 83.)

On December 31, 1936, the new company had assets of a book value of \$858,332.19. It had liabilities of \$370,661.74; a capital stock account of \$390,000, of which \$300,000 was allocated to the 30,000 class A shares and \$90,000 to the 45,000 common shares, and a book surplus of \$97,670.45. Land was carried among the assets at a book value of \$618,674.83. (R. 83.) In 1934, 1935 and 1936, the old company's net income and dividends were as follows (R. 83-84):

	1934	1935	1936
Net income.....	\$64,025.26	\$65,834.77	\$70,052.26
Dividends.....	12,000.00	32,000.00	11,000.00

The class A shares of the new company are entitled to cumulative preferential annual dividends of 60 cents a share and to a further participating dividend equal to any dividend declared or paid on the common shares for the same period after the common shares shall have received a dividend of 60 cents for that period. Holders of class A shares are entitled to one vote a share, and upon liquidation shall be preferred as to assets to the extent of \$10 a share plus accumulated and unpaid dividends. (R. 84.)

The taxpayers were granted an extension of time, expiring on June 1, 1937, for filing their income tax returns for 1936. An accountant employed by them completed preparation of the returns on May 29, 1937. The returns, properly signed and sworn to, were delivered

to the Collector. Swan's return is stamped by the Collector as filed on June 2, 1937. (R. 84.)

The Board held (1) that the Commissioner had correctly determined that taxable gain was realized upon cancellation of the taxpayers' debts in the amounts of \$80,009.14 and \$35,040.66 for Swan and Whitthorne, respectively; (2) that the basis used by the Commissioner in determining the gain on the sale of the stock was correct but that the gain should be reduced so as to be applicable only to the sale of 12,500 shares (which were delivered in 1936); and (3) that the taxpayers were liable for a penalty of 5% for failure to file their returns in time inasmuch as the evidence does not establish that the delay was due to a reasonable cause. (R. 90.)

Accordingly the Board decided that there is a deficiency in the case of *Minnie L. Whitthorne v. Commissioner* of \$6,894.24 in income tax and a penalty of \$344.71; and a deficiency in the case of *Sherwood Swan v. Commissioner* of \$38,687.37 in income tax and a penalty of \$1,934.36. (R. 91-92.)

SUMMARY OF ARGUMENT

1. It has been authoritatively established that a solvent taxpayer realizes taxable gain upon the cancellation of his debt for less than the sum owed. The Board found that the taxpayers here were solvent after the settlement of the debts which they owed two creditors and that they had clear assets in excess of the portions cancelled. As the evidence supports the Board's finding relative to solvency, the taxpayers have failed to

establish their contention that they were insolvent after the debt settlement.

Under the facts of this case, the taxable gain equals the amount of the debts cancelled. Thus the taxpayers are in error in urging that the measure of such gain should be the amount of the assets freed from a particular lien and in asserting that a considerable portion of the assets was freed from their debts in 1930 when the pledge of certain stock was given to their creditors. The fact that such pledge limited the amount which could be recovered from the pledged assets does not make the amount of gain less than the cancelled debt. It is true that taxable gain is realized because assets are freed when a debt is cancelled without the payment of any cash or property. But such freeing of assets is accomplished not by release from a special pledge but from the general burden of debt, and so the term "freed assets" means the amount of assets which constitute a taxpayer's surplus over liabilities, after cancellation of part of the latter.

2. The Commissioner determined that, in computing the gain realized by the taxpayers upon the sale of a portion of their new class A stock of Sherwood Swan Company, the cost of the old stock should be distributed between the class A stock and their new common stock. This determination was properly accepted by the Board inasmuch as the new stock was acquired as a result of a nontaxable exchange, and the evidence shows that the common stock, as well as the class A stock, had a market value. Consequently neither the facts here, nor the decisions support the taxpayers in contending that

the whole cost of the old stock should be allocated to the class A stock.

3. The Board correctly sustained the Commissioner's determination that the taxpayers are subject to a penalty of 5% for failure to file their returns on time since the evidence fails to establish that there was reasonable cause for the delay.

ARGUMENT

I

The Board correctly held that the taxpayers realized taxable gain in the taxable year from the settlement of certain debts by the payment of an amount less than the sums owed

The Commissioner determined that upon the settlement of the debts owed by the taxpayers to the Bank of America and the Central National Bank of Oakland, they realized taxable gain to the extent of the excess of the debts owed over the sums paid, or a gain of \$80,009.13 for Swan and of \$35,040.66 for Whitthorne. (R. 21-23, 56-58.) In approving the Commissioner's determination, the Board followed a rule which was first announced by the Supreme Court in *United States v. Kirby Lumber Co.*, 284 U. S. 1. In that case the taxpayer had issued its bonds at par and later purchased some of them at less than par. The Court held that the difference between par and the purchase price constituted income and so decided, in substance, that a taxpayer may realize taxable gain by settling his obligations for a sum less than their face amount. A similar conclusion was reached in *Helvering v. Amer. Chicle*

Co., 291 U. S. 426, and *Commissioner v. Coastwise Transp. Corp.*, 71 F. 2d 104 (C. C. A. 1st), certiorari denied, 293 U. S. 595. See also Article 22 (a)-14 of Treasury Regulations 94, Appendix, *infra*.

This principle is now generally accepted as applicable to the cancellation of any kind of indebtedness, but a number of cases have announced an exception to the rule. Thus, while there is nothing to indicate that the above decisions were dependent upon the debtor's solvency, and the net worth of a taxpayer is not a criterion in other kinds of cases for determining when taxable income is realized, yet it has been held that the above rule is applicable only when the debtor is solvent. *Dallas T. & T. Warehouse Co. v. Commissioner*, 70 F. 2d 95 (C. C. A. 5th); *Commissioner v. Simmons Gin Co.*, 43 F. 2d 327 (C. C. A. 10th); *Madison Railways Co. v. Commissioner*, 36 B. T. A. 1106; *Springfield Industrial Building Co. v. Commissioner*, 38 B. T. A. 1445. But this limitation on the general rule has been qualified by the holding that if a taxpayer becomes solvent upon the cancellation of his debt, he is taxable to the extent that his assets then exceeded his liabilities. *Haden Co. v. Commissioner*, 118 F. 2d 285 (C. C. A. 5th); *Lakeland Grocery Co. v. Commissioner*, 36 B. T. A. 289. Accordingly, under the present interpretation of this rule, we are required at the outset, in order to know if and how the rule is to be applied, to determine whether the taxpayers were solvent after the cancellation of their debts and to find out what were the amounts of their clear assets thereafter.

- (a) The taxpayers were solvent after the debt settlement and each had clear assets in excess of the amount of his cancelled debt

The Commissioner treated the taxpayers as solvent persons and the Board accepted this view, finding that after the debt settlement in 1936, each had clear assets in excess of the amount of his cancelled debt. Specifically, the Board found that the liabilities of Swan on December 16, 1936, after the settlement aggregated \$131,335.93 and that his cancelled debt amounted to \$80,009.13. Thus Swan's assets on that day would equal an amount in excess of the sum of these two items, or in excess of \$211,345.08. As to Whitthorne, the Board found that he had liabilities on that day of \$101,500, and that his cancelled debt amounted to \$35,040.66. Thus his assets would be an amount in excess of these two figures, or in excess of \$136,540.66. (R. 81.) The Board also indicated that there was nothing to show that either taxpayer was insolvent before the settlement. (R. 86.)

In denying their solvency the taxpayers do not discuss the Board's findings or even indicate that they are aware that findings of fact have been made against them, but, of course, to prevail here the taxpayers must show that the Board's findings are not supported by the evidence. At the hearing, the taxpayers introduced a statement as to Swan's assets which shows that after the settlement he had a net solvency of \$10,500.83. (R. 204). As to Whitthorne, the taxpayers do not contend that he was insolvent but assert that his net solvency was only \$3,500. (R. 86, Br. 31-32.) These figures were obtained by placing a value of \$105,000 on

the 500 shares of Sherwood Swan & Company, which constituted the assets of each. We shall discuss that valuation hereinafter and dispose first of taxpayers' alternative contention that in determining solvency the cost of such stock should be used as its value and hence that the net insolvency of each taxpayer was in excess of \$50,000. (Br. 27-28.)

We submit that in determining solvency there is no authority for using cost as the value of assets. It is apparent that the taxpayers here, as well as the Board, understand solvency to mean the presence of assets in an amount equal to, or in excess of, liabilities. This view is in accord with that taken in bankruptcy proceedings in which the term "insolvency" is defined as the financial status of a person whose assets, *at a fair valuation*, are not sufficient to pay his debts. *Continental Bank v. Rock Island Ry.*, 294 U. S. 648. This definition has also been adopted in some tax cases and is undoubtedly the sense in which the term "insolvency" is used in cases like the instant one. See *Commerce Trust Co. v. Woodbury*, 77 F. 2d 478 (C. C. A. 8th), certiorari denied, 296 U. S. 614; *Haden Co. v. Commissioner*, *supra*. It will be noted that this definition prescribes "a fair valuation" for assets, which obviously might be more or less than cost but should approximate the present worth of the assets after due consideration is given to all pertinent factors. The decisions cited by the taxpayers (Br. 25), in which fair market value where lower than cost is used, are not in conflict with this view but merely indicate that the actual value of assets at the time of the cancellation of

the debt is the one to be used. The taxpayers' objection to the use of fair market value higher than cost on the ground that it results in double taxation or causes a tax to be imposed on unrealized gain cannot be sustained but will be discussed below.

Thus, in determining solvency, we should apply the above definition and should accept the Board's finding here in regard to the amount of clear assets after the debt settlement, if supported by any substantial evidence. As the amount of the liabilities is not disputed and as the principal asset of each taxpayer, both before and after the settlement, was the stock of the Sherwood Swan Company, this point depends principally upon the evidence relative to the value of such stock, the entire issue of 1,000 shares (old stock) being held by the taxpayers, 500 shares each.

As we have indicated, under one of the taxpayers' estimates of their net worth, this stock was included at cost, which was \$100,000 for the 1,000 shares. (Br. 22-28.) But under another theory, which was also presented at the hearing, they value the stock at \$210,000 which they claim to be the fair market value. (Br. 31-32.) We submit that both figures are too low. The figure of \$210,000 was reached by multiplying the total number of class A shares received by them upon the reorganization (which was almost simultaneous with the debt settlement) by \$7, the price per share paid by the broker for a portion of such stock when it was turned over for resale to the public. (Br. 7.) In addition to the class A shares each taxpayer also received 22,500 shares of new common stock which the

Board found (R. 87) had substantial value, and which paid dividends for at least two years after its issuance. (R. 161.) Nevertheless in this estimate of their net worth, no value whatsoever is given to the new common stock. (R. 222.)

In this connection attention is also called to the fact that the \$210,000 estimate for the old stock is less than the amount for which it was pledged to the banks in 1930. As to this, the evidence shows that the stock was pledged for \$200,000 on the original loans made by the banks, plus \$35,000 for the Robinson loan assumed by the banks, and accrued interest on the latter amount. (R. 108.) It should be noted further that the parties then considered the amount of this pledge, which was in excess of \$235,000, as only a portion of the value of such stock, and this is still the view of the taxpayers for there are numerous references throughout their brief to their equity in such stock, which was, of course, the excess above the amount for which the pledge was given.

Inasmuch as the taxpayers owned all of the stock of Sherwood Swan & Company, it seems reasonable to hold that its value should approximate the net assets of the company, and there is support for such a view in the evidence. The assets of the new company were carried on its book on December 31, 1936, at \$858,339.17; its current and long term liabilities at \$370,661.74; its capital stock account at \$390,000 and its surplus amounted to \$97,670.45. (R. 83, 219.) It will be seen from these figures, that if the net assets, totalling over \$488,000, had been divided between the taxpayers they

would have each received over \$244,000, and we submit that it is not unreasonable to give each taxpayer's old stock a value which would approximate such a figure. This also appears to have been the opinion of the Board whose function it is to weigh the evidence.

In support of this view is the report of an engineer who made an appraisal of the property on December 14, 1936, in connection with the company's reorganization. He estimated its land, buildings and equipment to be worth \$710,000 at that time. This was not much smaller than the book value of such assets and in addition to this the company had other assets amounting to over \$115,000. (R. 152, 219.) Even the taxpayers' witnesses, who gave their opinion at the hearing as to the value of the company's land without improvements, estimated that the land by itself was worth around \$200,000 in 1936. (R. 135, 138.)

But perhaps a more important factor is that this company had been making money. During 1936, as well as in each of the two preceding years, it had a net income which it will be seen averaged about 8% of the book value of its total gross assets. Furthermore in each of those years and also for the two years succeeding 1936, the company paid dividends. (R. 83-84.) These are proper factors to consider in determining value. *Joseph S. Wells Ass'n v. Helvering*, 71 F. 2d 977 (App. D. C.).

The Board stated that it was not necessary for it to reach a definite value for this stock as the facts preclude a finding of insolvency, and it found that the clear

assets ⁴ of the taxpayers after the settlement was in excess of the amounts of the debts cancelled. We submit that the evidence amply supports this conclusion and that the rule of the *Kirby* case and other similar cases is applicable here.

(b) The taxable gain received by the taxpayers upon settlement of their debts is measured by the amount of the debts cancelled

It is generally conceded that the principal reason for holding that a cancelled debt constitutes taxable gain is that there is a freeing of assets which the taxpayer has held and could have used to discharge his debts. But it should be evident that in using the term "freeing of assets", we are not referring to the release which occurs when a creditor agrees to limit his recovery on

⁴ To support the Board's finding, it is only necessary to show that after the settlement, Swan had assets in excess of liabilities (which amounted to \$131,335.95), plus \$80,009.13 (the amount of his debts which had been cancelled) or \$211,345.08 (R. 81).

In addition to the stock of Sherwood Swan & Company, which had a book value of about \$244,000, Swan's estimate (R. 203) shows a ranch valued at \$6,000 and current assets due from Sherwood Swan & Company of \$9,835.12 (but this is also given at \$16,182.23 at R. 219). Thus even at a valuation for stock, some lower than the above figure, Swan's total assets would still be in excess of \$211,345.08 and his clear assets in excess of the amount of the cancelled debt.

The same conclusion can be reached as to Whitthorne. His liabilities after the settlement amount to \$101,500, and his debts were cancelled to the extent of \$35,040.66. These items make a total of \$136,540.66, which would be the minimum value his gross assets could have in order to tax him on the amount of the debt cancelled, but as he also had stock with a book value of \$244,000, his clear assets would undoubtedly exceed the amount of his liabilities and leave more than the amount of the cancelled debt. (R. 81.)

a loan to a portion of the value of pledged assets and so in this technical sense releases the excess value to the debtor. After such release, the debtor would have just as much of debt as before. Consequently, the taxpayers are in error here in claiming that when their stock was pledged with the banks in 1930 for \$200,000, the excess was released within the meaning of the rule to be applied here and constituted income in that year. (Br. 19-21.) Thus while the banks could not force the taxpayers to pay anything from the stock above the amount for which it was pledged, such a release of their equity did not create income nor make the taxpayers any richer than they were before since their liabilities remained just as they were. In referring to this, the taxpayers state that the 1930 agreement with the banks "did not itself constitute a complete cancellation of any indebtedness" (Br. 17), but this is a misleading statement since none of the debts was cancelled in 1930. Furthermore the undisputed testimony shows that it was not then the intention of the parties to cancel any portion of such debts. (R. 118-120, 187.) Thus nothing happened in 1930 which could have resulted in taxable gain. Cf. *Walker v. Commissioner*, 88 F. 2d 170 (C. C. A. 5th).

The underlying theory of this case was well explained by the Board as follows (R. 87):

A solvent taxpayer realizes a gain by a reduction of his debt irrespective of whether the debt is secured by a pledge or mortgage. The freeing of assets which has been regarded in the decisions as a significant fact is not the release of the pledged security from lien, but the effect of

enabling the debtor to use all his assets freed from the incubus of the debt. The obliteration of the offsetting liability for debt is what constitutes the gain. * * *

Accordingly, we submit that the situation here is not materially different from that in a case where there is no pledge of certain assets. Even though the banks did agree that they would restrict their recovery from the pledged stocks to a certain figure, this does not mean that the taxpayers could not, or did not, hold their equity in such stocks for the payment of any of their debts, including these to the banks; and there is nothing repugnant about such a suggestion for it may be properly assumed that a debtor intends to pay his debts and that he holds his assets for that purpose whether or not he can be compelled by his creditor to use particular assets for payment thereon. Moreover in setting up a proper balance sheet, these taxpayers must include all of their assets, as well as their liabilities, and only by offsetting the total assets against the total liabilities can they determine what, if any, surplus they have. Until the debts here involved were cancelled in 1936, they had to be included in the liabilities, and only when they were eliminated through cancellation was there a decrease in the total liabilities to be offset against the assets and a freeing of assets in a corresponding amount.

This being the theory underlying the applicable rule, it is clear that the imposition of a tax here does not result in double taxation. The taxpayers' contention (Br. 24-25) that it does, apparently assumes that this

tax is imposed on the value of the pledged stock which was released upon the debt-settlement in 1936 and later sold and that another tax being imposed on the gain from the sale would be on the same item. But it is obvious that the gain resulting from the cancellation of a debt is not a gain on any particular asset. Consequently, even though a taxpayer may have only one asset he will realize taxable gain twice, if he has any portion of his debts cancelled without payment, and if he sells such asset at a profit. The amount of the gain in each instance will, of course, not be the same ordinarily and will depend upon the facts of the two transactions, each being entirely distinct.

It is also erroneous to claim that the Government is trying to impose a tax on unrealized gain for it should be equally clear that gain from a cancelled debt is realized since thereafter the debtor actually has less of debt and more of assets than he had before. His gain is not comparable to the anticipated gain due to a rise in the value of property which being subject to fluctuation may never be converted into income.

II

The Board properly determined the portion of the cost of the taxpayers' old stock which should be used as the cost basis of the new class A stock which they sold

In connection with the reorganization of Sherwood Swan & Company in, December, 1936, the taxpayers surrendered their 1,000 shares of old stock and received in a nontaxable exchange 30,000 class A shares with a par value of \$10 and 45,000 common shares with no par value. (R. 82.) Through an agreement with a brokerage firm, 25,000 class A shares were to be sold

by the brokers to the public, with the latter paying the taxpayers \$7 per share. Under Section 113 (a) (6) of the Revenue Act of 1936 (Appendix, *infra*), the basis for determining gain on the sale of such new shares is the same as that for the old stocks, but the taxpayers now argue⁵ that the gain on the shares sold in 1936 should be computed by allocating the total cost of the old shares to the class A shares because the new common stock had no fair market value in December, 1936. In support of their contention, the taxpayers cite *Axton v. Commissioner*, 32 B. T. A. 613, but while the facts in that case are somewhat similar to those here, particular attention is called to the difference in the Board's findings in the two cases. In the *Axton* case, the Board made the specific finding that the new class B stock had no fair market value or any value on which a practicable allocation of the cost of the old shares could be made and so held that the whole cost should be assigned to the new shares.

But that is not the case here. The Board found in the instant case that the new common shares had substantial value, and that the Commissioner's distribution of 50.84% of the cost of the old shares to the class A stock, and 49.16% to the common, was a proper allocation and the best which the taxpayers could demand in view of the evidence showing the value of the company's

⁵ The taxpayers were first of the opinion that there should be an allocation. Thus, at the hearing the accountant who prepared the taxpayers' returns testified that he had allocated the cost of the old shares to both classes of new stock after considering earnings and book value of assets. (R. 164-165.) Swan also testified that he had considered their allocation of cost to both kinds of stock a fair one. (R. 153.)

assets, their earning power, and the ability to pay dividends on the common as well as on the class A stock. (R. 87, 89.) Consequently, the taxpayers here were first confronted with the Commissioner's determination, which was presumed to be correct until overcome by them but they failed in that burden (*Commissioner v. Swenson*, 56 F. 2d 544 (C. C. A. 5th)); and they are now confronted with the Board's finding of fact that the common stock had value.

In support of this finding, the record shows that in 1936, this company had a net income of about \$70,000. This would have been sufficient to pay the \$18,000 required for the preferential annual dividend of sixty cents on the 30,000 class A shares; and also enough to pay the \$27,000 needed to pay a sixty cents dividend⁶ on 45,000 common shares, and there would still have been \$25,000 of the net income remaining. The net income for earlier years approximated that for 1936, and dividends were not only paid for such years but for two years after 1936, dividends were paid on the new common stock. We submit that after giving due consideration to all the facts, the Board properly found that the common shares had substantial value and that the Commissioner had made a fair determination as to the allocation. There is no evidence that the stock could not have been sold if offered for sale, and the fact that no sale was made does not mean that it had no market

⁶ Common stock was entitled to such dividend after the same dividend had been paid on class A stock. Thereafter, the two kinds of shareholders got equal dividends. (R. 84.)

value. *Crowell v. Commissioner*, 62 F. 2d 51, 53 (C. C. A. 6th).

The practice of allocating cost of old stock to two classes of new stock has been approved in a number of cases involving facts similar to these here. See *Baker v. Commissioner*, 115 F. 2d 987 (C. C. A. 6th); *Salvage v. Commissioner*, 76 F. 2d 112 (C. C. A. 2d), affirmed on another issue, 297 U. S. 106; *Curtiss v. Commissioner*, 57 F. 2d 847 (C. C. A. 5th); *Houghton v. Commissioner*, 71 F. 2d 656 (C. C. A. 2d); *Collin v. Commissioner*, 32 F. 2d 753 (C. C. A. 6th). Accordingly such procedure is not novel, and it is not unfair to the taxpayers. Furthermore they have failed to sustain their burden as to this point.

III

The taxpayers are subject to a penalty for failure to file their tax returns in the time required

The taxpayers were granted two extensions of time for filing their tax returns for 1936, the last of which expired on June 1, 1937. Section 53 (2) of the Revenue Act of 1936 (Appendix, *infra*), authorizes the Commissioner of Internal Revenue to grant extensions under such regulations as he may prescribe. Article 53-4 of Treasury Regulations 94 (Appendix, *infra*), promulgated under that section, provides that the due date, when an extension has been granted, shall be the last day of the period covered by the extension. Thus, the taxpayers here were required to file their returns on June 1st.

As the returns were stamped by the Collector as being filed on June 2, 1937 (R. 84), the Commissioner added a penalty of 5% in accordance with Section 291 of the Revenue Act of 1936 (Appendix, *infra*), which provides for such penalty when no reasonable cause is shown for failure to file the return within the prescribed time. The Board sustained this penalty after finding that the evidence failed to establish that the delay was due to reasonable cause rather than to willful neglect. (R. 90.)

We submit that this is a proper finding. The accountant who prepared the returns for the taxpayers testified that he finished the returns on Saturday, May 29th, and turned them over to Swan (one of the taxpayers) on the morning of Tuesday, June 1st, which was the next business day (R. 168-169). Swan testified that what happened thereafter was "just a little bit hazy in my mind", but that he thought he took the returns to the office of the Internal Revenue Bureau in Oakland late that afternoon and, finding the office closed, slipped them through the slot in the door. However, Swan qualified this statement by explaining that he believed he did this because he had done so on one occasion and this might have been the time. (R. 179-180). Obviously, this evidence is too indefinite to rebut the filing date stamped on the returns by the Collector's office. Moreover, even if the returns were left at the Collector's office after hours on June 1st, such act would not constitute a filing on that date. A paper is not filed until it is delivered and received by the proper official

for filing. *United States v. Lombardo*, 241 U. S. 73, 76; *Poynor v. Commissioner*, 81 F. 2d 521 (C. C. A. 5th); Bouvier's Law Dictionary. Obviously, these returns were not received by any official on June 1st. Thus, this case is distinguishable from *Perkins v. Commissioner*, 33 B. T. A. 606, cited by the taxpayer, for in that case there was definite evidence that the returns had been delivered during office hours to the proper official, and that the Collector had inadvertently stamped the filing date as the following day. However, in the absence of positive evidence, as in the instant case, the Collector's stamp must be treated as conclusive.

The case of *Edwards v. Grand*, 121 Cal. 254, which the taxpayer also cites, is not in point even if a state decision can be treated as controlling. The question there was which of two instruments should be given precedence, and it was decided that the one which was delivered first to the recorder at his office, although delivery was made after office hours and actual filing occurred the subsequent morning. The other paper had been handed to the recorder the next morning on the way to his office with directions for filing. This case cannot be treated as authority for holding that a federal tax return which was not handed to any official on the date for filing, but was merely left at the office after hours, was filed within the meaning of the revenue statute.

Accordingly, June 2nd must be accepted as the date of filing and as no reason whatsoever was offered for the delay, the penalty is mandatory. Such holding is

in accord with this Court's decision in regard to the same penalty in *J. K. McAlpine Land & D. Co. v. Commissioner*, 126 F. 2d 163. Also see *West Side Tennis Club v. Commissioner*, 111 F. 2d 6 (C. C. A. 2d), certiorari denied, 311 U. S. 674.

CONCLUSION

The Board's decision should be affirmed as to all issues.

Respectfully submitted.

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AUGUST 1942.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from * * * businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

SEC. 53. TIME AND PLACE FOR FILING RETURNS.

(a) *Time for Filing.*—

(1) *General Rule.*—Returns made on the basis of the calendar year shall be made on or before the 15th day of March following the close of the calendar year. Returns made on the basis of a fiscal year shall be made on or before the 15th day of the third month following the close of the fiscal year.

(2) *Extension of Time.*—The Commissioner may grant a reasonable extension of time for filing returns, under such rules and regulations as he shall prescribe with the approval of the Secretary. Except in the case of taxpayers who are abroad, no such extension shall be for more than six months.

(b) *To Whom Return Made.*—

(1) *Individuals.*—Returns (other than corporation returns) shall be made to the collector

for the district in which is located the legal residence or principal place of business of the person making the return, or, if he has no legal residence or principal place of business in the United States, then to the collector at Baltimore, Maryland.

* * * * *

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss*.—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain * * *.

* * * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule*.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * * *

(3) *Stock for Stock on Reorganization*.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property*.—The basis of property shall be the cost of such property; except that—

* * * * *

(6) *Tax-free Exchanges Generally.*—If the property was acquired, after February 28, 1913, upon an exchange described in section 112 (b) to (e), inclusive, the basis (except as provided in paragraph (15) of this subsection) shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. * * *

* * * * *

SEC. 291. FAILURE TO FILE RETURN.

In case of any failure to make and file return required by this title, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the tax: 5 per centum if the failure is for not more than thirty days with an additional 5 per centum for each additional thirty days or fraction thereof during which such failure continues, not exceeding 25 per centum in the aggregate. The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amount so added shall be collected in the same manner as the tax. The amount added to the tax under this section shall be in lieu of the 25 per centum addition to the tax provided in section 3176 of the Revised Statutes, as amended.

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 22 (a)–14.¹ *Cancellation of indebtedness.*—The cancellation of indebtedness, in whole

¹ This article was amended by T. D. 4871, 1938–2 Cum. Bull. 130, in a respect not material here.

or in part, may result in the realization of income. If, for example, an individual performs services for a creditor, who in consideration thereof cancels the debt, income in the amount of the debt is realized by the debtor as compensation for his services. A taxpayer realizes income by the payment or purchase of his obligations at less than their face value. (See article 22 (a)-18.) If a shareholder in a corporation which is indebted to him gratuitously forgives the debt, the transaction amounts to a contribution to the capital of the corporation. * * *

* * * * *

ART. 53-4. *Due date of return.*—The due date is the date on or before which a return is required to be filed in accordance with the provisions of the Act or the last day of the period covered by an extension of time granted by the Commissioner or a collector. When the due date falls on Sunday or a legal holiday, the due date for filing returns will be the day following such Sunday or legal holiday. If placed in the mails, the returns should be posted in ample time to reach the collector's office, under ordinary handling of the mails, on or before the date on which the return is required to be filed. If a return is made and placed in the mails in due course, properly addressed and postage paid, in ample time to reach the office of the collector on or before the due date, no penalty will attach should the return not actually be received by such officer until subsequent to that date. If a question may be raised as to whether the return was posted in ample time to reach the collector's office on or before the due date, the envelope in which the return was transmitted will be preserved by the collector and forwarded to the Commissioner with the return. As to additions to the tax in the case of failure to file return within the prescribed time, see section 291.

* * * * *

ART. 291-1. *Addition to the tax in case of failure to file return.*—In case of failure to make and file a return required by Title I within the prescribed time, a certain percent of the amount of the tax is added to the tax unless the return is later filed and failure to file the return within the prescribed time is shown to the satisfaction of the Commissioner to be due to reasonable cause and not to willful neglect. * * *

* * * * *

A taxpayer who files a tardy return and wishes to avoid the addition to the tax for delinquency must make an affirmative showing of all facts alleged as a reasonable cause for failure to file the return on time in the form of an affidavit which should be attached to the return. If such an affidavit is furnished with the return or upon the collector's demand, the collector, unless otherwise directed by the Commissioner, will forward the affidavit with the return, and, if the Commissioner determines that the delinquency was due to a reasonable cause, and not to willful neglect, the addition to the tax will not be assessed. If the taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the return within the prescribed time, then the delay is due to a reasonable cause.

* * * * *

No. 10,087

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

MINNIE L. WHITTHORNE and EVA WHIT-
THORNE, Executrices of the Estate of
W. R. Whitthorne, Deceased,

Petitioners,

VS.

COMMISSIONER OF INTERNAL REVENUE,

Respondent,

and

SHERWOOD SWAN,

Petitioner,

VS.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

REPLY BRIEF OF PETITIONERS-APPELLANTS.

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FILED

OCT - 9 1942

PAUL P. O'BRIEN,

CLERK

Not petitioners

Subject Index

	Page
I. The taxpayers did not receive taxable gain in 1936 by the settlement with their bank creditors.....	1
1. <u>Stock</u> was freed in 1930 from all debt in excess of \$200,000.00; no further freeing was accomplished in 1936 except \$5000.00.....	2
2. Any income to petitioners incident to the release of assets occasioned by the <u>cancellation</u> of indebtedness cannot exceed the cost basis of such assets of petitioners	3
3. There was no cancellation of indebtedness by Bank of America in 1936.....	5
4. The cancellation being without consideration did not constitute income to the taxpayers.....	7
II. In determining whether any capital gain was realized on the sale of the class A stock, all the cost basis should be allocated to that stock and none to the common stock since the latter had no fair market value <i>They thought it did</i>	9
III. Petitioners should be relieved from the five per cent penalty for the alleged one-day delay in filing their returns <i>Check the</i>	12
Conclusion	14

cases - is this negligence.

Table of Authorities Cited

Cases	Pages
American Dental Co. v. Commissioner, 128 Fed. (2d) 254..	7
Axton v. Commissioner, 32 B.T.A. 613.....	9, 11
Baker v. Commissioner, 115 Fed. (2d) 987.....	11
Belridge Oil Co. v. Commissioner, 69 Fed. (2d) 432.....	10
Collin v. Commissioner, 32 Fed. (2d) 753.....	12
Commerce Trust Co. v. Woodbury, 77 Fed. (2d) 478.....	3
Commissioner v. Bonwit (C.C.A. 2nd), 87 Fed. (2d) 764...	9
Curtiss v. Commissioner, 57 Fed. (2d) 847.....	11
Haden Co. v. Commissioner, 118 Fed. (2d) 285.....	3
Houghton v. Commissioner, 71 Fed. (2d) 656.....	11
J. K. McAlpine Land & D. Co. v. Commissioner, 126 Fed. (2d) 163	14
Madison Railways Co. v. Commissioner, 36 B.T.A. 1106....	3
Pearsoll v. Commissioner, 29 B.T.A. 747.....	13
Poynor v. Commissioner, 81 Fed. (2d) 521.....	13
Salvage v. Commissioner, 76 Fed. (2d) 112.....	11
United States v. Lombardo, 241 U. S. 73.....	13
West Side Tennis Club v. Commissioner, 111 Fed. (2d) 6...	14

Miscellaneous

California Political Code, sections 1030 and 4312.....	13
Paul & Mertens on Income Tax, section 743.....	2

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SHERWOOD SWAN,

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vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

REPLY BRIEF OF PETITIONERS-APPELLANTS.

**I. THE TAXPAYERS DID NOT RECEIVE TAXABLE GAIN IN
1936 BY THE SETTLEMENT WITH THEIR BANK CREDITORS.**

This is an effort to collect from appellants tax on "negative income". "Negative income" is a phrase coined by Paul & Mertens to describe a situation like the present one where a taxpayer has not received any real income but is simply less involved financially than he was before by reason of the act of his creditors in

the cancellation of part of his indebtedness. (Paul & Mertens on Income Tax, Sec. 743.)

1. **STOCK WAS FREED IN 1930 FROM ALL DEBT IN EXCESS OF \$200,000.00; NO FURTHER FREEING WAS ACCOMPLISHED IN 1936 EXCEPT \$5000.00.**

Counsel for the Government concede on page 17 of their brief that the only basis for treating a cancellation of debt as taxable income is the "freeing of assets" involved. Yet they argue on page 19 that because the debt was still carried after 1930 on the balance sheet as a liability, the rule is inapplicable. They further contend that the equity in such stock was still held for the payment of the bank debt. This is not correct. It was not merely partially released from pledge. The taxpayers could have obtained the freedom of their stock without further pursuit at any time upon payment of \$200,000.00.

Counsel admit that the only theory upon which the transaction can be characterized as income at all is that the taxpayer has something usable and "free" that he did not have before. Before 1930 the taxpayers' stock was hopelessly encumbered by \$445,000.00 of bank debt. After that partial freeing it was encumbered only to the extent of \$200,000.00. In other words it was more than one-half freed from its load of debt, and to that extent was more usable to the taxpayer. Suppose the creditors in 1930 had freed the stock from all pursuit except to the extent of \$1.00 (instead of \$200,000.00), certainly the Government could not contend that the assets were not substantially freed in 1930. So here the stock was freed in 1930 of 55% of its burden, leaving only \$200,000.00 to be paid off in

1936. The taxpayers in fact paid no more than \$195,000.00 in 1936 so that the stock was only freed of \$5000.00 of cancelled debt in that year.

2. ANY INCOME TO PETITIONERS INCIDENT TO THE RELEASE OF ASSETS OCCASIONED BY THE CANCELLATION OF INDEBTEDNESS CANNOT EXCEED THE COST BASIS OF SUCH ASSETS OF PETITIONERS.

There is conflict between counsel for the Government and ourselves as to the meaning of "insolvent" as used in such cases as *Madison Railways Co. v. Commissioner*, 36 B. T. A. 1106. The Government urges that it has the same meaning as "insolvent" in the Bankruptcy Law, i.e., the condition of having assets which at a fair value are not sufficient to pay debts.

However, they do not find a single case in which the assets in such a debt cancellation transaction have been computed at a figure in excess of costs. They cite *Commerce Trust Co. v. Woodbury*, 77 Fed. (2d) 478, and *Haden Co. v. Commissioner*, 118 Fed. (2d) 285. The first case is not a tax case at all but a fraudulent transfer under state law. In *Haden Co. v. Commissioner* the Court does not state on what basis it is figuring the value of the assets. The fact that an uneven figure is used—\$149,644.98—is some indication that it was book value. If it was figured as the result of an appraisal of present fair value it would more likely be an even figure. But the case is not of any help because it does not indicate its basis.

We believe that it is demonstrable that cost is the only basis that can be justifiably used. May we make our point clear by a series of illustrations:

a. Assume a taxpayer's sole asset is stock which cost him \$5000.00 and which is now worth \$10,000.00 and which is pledged to the bank to secure \$100,000.00 debt. Assume the bank cancels \$50,000.00 of his debt. In spite of such partial relief he receives no taxable income because his stock is still subject to the burden of the remaining \$50,000.00 of debt.

b. Assume the bank cancels \$95,000.00 of the debt, leaving only \$5000.00 due. Still the taxpayer will not have received income because his \$5000.00 stock is still subject to the burden of the remaining \$5000.00 debt. It is true that he can, if he wishes, go out and sell that stock for \$10,000.00, pay off his debt and have \$5000.00 profit. But it is the act of selling the stock at a price above cost that creates that profit, not the prior act of the creditor's cancelling the debt. For if the taxpayer does not immediately sell his stock but waits a year until its price again goes down to \$5000.00 and then sells it he will make no profit. Until such actual sale any possible profit is "unrealized" and is so uncertain of receipt that the income tax act does not recognize it.

c. Assume that the bank cancels the entire \$100,000.00 of debt. Then the taxpayer will immediately realize \$5000.00 income occasioned by his \$5000.00 stock being freed from the burden of debt. The other \$5000.00 income he will receive, not because the stock is freed from debt, but only because he immediately elects to sell it for \$10,000.00 at a profit over cost. Until he does so elect to sell it, he does not receive that second item of profit.

Any other basis would be inconsistent with the theory of the law that only realized income is to be

taxed. Furthermore, if the freed stock should be valued at its present value instead of cost, then it would have to follow that such "steeped up" basis be used as the basis of the stock on any future sale. Otherwise the same increment in value would be taxed twice—once when the stock is released from debt and again when the stock is sold. That is exactly what the Commissioner is attempting to do here. In determining whether there was any profit on the debt cancellation he uses, not its cost but what he regards as the then market value of the stock, but when he is determining the profit realized on the sale of that stock a few days later he does not use that "stepped up" basis but reverts to the original cost of the stock and taxes the difference between the sale price and such cost. Accordingly he is taxing twice the difference between his estimate of the then market value and the original cost.

Applying the cost basis (which we have shown is the proper one) to the tables appearing on pages 26 to 28 of our opening brief, it is clear that neither taxpayer received any taxable income as a result of the cancellation indebtedness during the year 1936.

3. THERE WAS NO CANCELLATION OF INDEBTEDNESS BY BANK OF AMERICA IN 1936.

An examination of the findings (Record, pages 79-80) shows that the arrangement worked out with the receiver of the Central National Bank in December, 1936, was in fact a cancellation of indebtedness. A far different method, however, was used in the case of Bank of America. There was in that case no com-

promise involving a partial payment of indebtedness with forgiveness of the balance. On the contrary the findings (Record, page 80) and the evidence (Record, pages 213 to 217) shows that that bank conducted a formal pledgee's sale. At such sale the Sherwood Swan and Company stock was purchased by Sherwood Swan for \$100,000.00. The remaining securities were then offered for sale by the party conducting the auction and were bid in by the bank for an amount equal to the full remaining indebtedness, both principal and interest, from the taxpayers to the Bank of America—\$96,073.14. The party conducting the sale thereupon declared that the amount so bid constituted "full payment" of the notes and delivered the notes to the taxpayers marked "Paid". Clearly if a third party had purchased the pledged securities for the full amount of the indebtedness the bank would have been paid in full and there would have been no cancellation. There is no difference merely because the bank itself as purchaser bids at the pledgees' sale for an amount equal to the full amount of the indebtedness. It is true that the Board of Tax Appeals declares that the pledged securities purchased by the bank, other than the Hale Bros. Realty stock, were worthless. That is immaterial. The bank determined that it wanted them badly enough to bid \$96,073.14 for such securities including the Hale Bros. stock.

This clearly constituted a payment in full of the indebtedness and not a cancellation so far as the Bank of America indebtedness was concerned.

4. THE CANCELLATION BEING WITHOUT CONSIDERATION DID NOT CONSTITUTE INCOME TO THE TAXPAYERS.

Since the filing of the opening brief in this case the decision of the Seventh Circuit Court of Appeals in *American Dental Co. v. Commissioner*, 128 Fed. (2d) 254, has been published. That case is almost directly in point and lays down the rule that where a cancellation of indebtedness is made without consideration it does not constitute income. The tenant was there heavily indebted to his landlord who said to him, "Well, pay me \$7500.00, and I will call it square, and forget the rest of it." The tenant answered, "Well, I haven't \$7500.00." The landlord replied, "You worry about raising the \$7500.00; get busy and raise it and pay it when you can, and forget the rest of it." That conversation was in 1933 and was substantially similar to the arrangement made between the present taxpayers and the banks in 1930. In the *American Dental Company* case the \$7500.00 was paid in 1937 just as the agreed payments were made to the banks by taxpayers in the present case in 1936. In determining that the cancellation did not result in any income to the debtor, the Court said:

"There was no consideration to the landlord for the cancellation of the debt. * * * It forgave all but \$7,500 of the rent for no consideration whatsoever to the landlord, and merely as a benefit to the debtor. * * *

"Since, therefore, there was no consideration for the cancelled debts, and the cancellations inured only to the benefit of the debtor, the amount of the debts as cancelled is a gift from the creditors to the debtor, within the meaning of the

Treasury Department's regulations, and the debtor was not required to include it in gross income."

The Court held that the Board of Tax Appeals was erroneous in requiring evidence of donative intent, saying:

"Suppose the creditors did act for purely business reasons. As long as there was no consideration for the cancellation, the intent to give necessarily followed. Evidently the Board confused intent with motive. * * *

"Our decision may result in the Government getting no tax, although the taxpayer had benefited by deducting the rent and interest accrued.
* * *

"The unfairness of the Government's position is evidenced by taxing this sum of \$19,234.21 as excess profits received in 1937. Of course, the taxpayer never received a nickel it could have distributed as dividends. It received cancellation of debts for services and goods already consumed. How it could have distributed that as a dividend is not apparent. It is not difficult to imagine what would have happened to this debtor-taxpayer if it had inveigled its creditors into cancelling these debts on the basis that the debtor was hard up and then the debtor had distributed a like amount in dividends!

"We therefore hold that the indebtedness was cancelled for the benefit of the debtor and without consideration, and was not taxable. The decision of the Board of Tax Appeals is Reversed."

This case exemplifies the present thinking on this subject of taxing "negative" but unearned or unrealized income.

II. IN DETERMINING WHETHER ANY CAPITAL GAIN WAS REALIZED ON THE SALE OF THE CLASS A STOCK, ALL THE COST BASIS SHOULD BE ALLOCATED TO THAT STOCK AND NONE TO THE COMMON STOCK SINCE THE LATTER HAD NO FAIR MARKET VALUE.

This point was developed under heading VI of our opening brief on pages 25 to 30 thereof. We analyzed the facts of the reorganization, the circumstances of the conversion of the old stock, showed that these facts were exactly similar to the facts in *Axton v. Commissioner*, 32 B. T. A. 613, and that therefore the rule of the *Axton* case should apply to the effect that all the cost bases should apply to the Class A stock on the ground that the common stock had no fair market value. Counsel for the Government recognize the similarity of the *Axton* case to the present one. Their only effort to distinguish it is to claim that in the present case the Board found that the new common shares had substantial value. This is not correct. In the *Opinion* of the Board there are certain comments as to why the Commissioner allocated cost between A stock and common stock (Record, pages 88 and 89), but a careful study of the *Findings* shows that there is no finding whatever as to the value of the common stock or as to whether it had any market value.

The cases are clear that a statement in the Board's opinion cannot be considered as a substitute for a missing finding of fact. See *Commissioner v. Bonwit* (C.C.A. 2nd) 87 Fed. (2d) 764, where the Court said:

“The Board's opinion states that ‘there is no evidence that he or his employer intended or regarded them’—premium payments—‘as addi-

tional compensation,' and the respondent rightly asserts that this Court is bound by the Board's findings on questions of fact, if they find any support in the evidence. The Board's formal findings of fact make no reference to additional compensation, but do include a finding that the records of the corporation contain no resolutions pertaining to the policies, nor any agreement between the corporation and the respondent respecting them. The above-quoted sentence from the opinion was perhaps intended as a reference to the absence of evidence in the corporate records. * * * We are at liberty, therefore, to disregard the above-quoted statement from the opinion, if it may be considered as a finding of fact."

For the failure of the Board to find on such an essential issue the Court reversed in *Belridge Oil Co. v. Commissioner*, 69 Fed. (2d) 432. The Court there said:

"The 'findings of fact' of the Board of Tax Appeals are concerned largely with the recital of probative facts. There is no finding therein of the actual cash value of the option. It is only from the statements in the opinion and from the fact that judgment was entered for the respondent, and from the dissenting opinion which construes the majority opinion as holding that the actual cash value of the option was only \$25,000, that the actual cash value of the option is to be inferred.

"It is the duty of the Board of Tax Appeals to find the facts upon which the validity of the proposed deficiency tax depends. Upon the petition to review, we are concerned only with the

question as to whether or not the facts found sustain the legal conclusions deduced therefrom. * * *

“All that we have said in this matter is for the purpose of emphasizing the fact that there is no direct finding by the Board of Tax Appeals on the ultimate fact involved in the determination of this appeal, and, consequently, that the case must be returned to them for such a finding.”

In the light of this decision this Court can either now treat the case as exactly similar to the *Axton* one or reverse it with directions to the Board to make findings as to whether the common stock had any fair market value.

None of the cases cited by counsel for the Government on page 23 of their brief are at all helpful.

In *Baker v. Commissioner*, 115 Fed. (2d) 987, the common stock had been sold to forty-one employees, thus fixing a market value for it. See the case as reported before the Board in 37 B. T. A. 1135 at page 1155.

In *Salvage v. Commissioner*, 76 Fed. (2d) 112, the Court declared “there can be no doubt it could have been sold if offered.” There is no evidence in the present case of any similar possibility of sale of the common stock.

In *Curtiss v. Commissioner*, 57 Fed. (2d) 847, each of the two securities was sold within a few months after the exchange, thus furnishing a definite standard of market value.

In *Houghton v. Commissioner*, 71 Fed. (2d) 656, the Board had been able to find a market value for

the common stock by the application of a formula, taking into consideration the application of a portion of average earnings to tangible assets and the balance to intangible assets. There was no basis for any similar formula here nor was any such formula set up.

In *Collin v. Commissioner*, 32 Fed. (2d) 753, the case was reversed and returned to the Board to take evidence as to the value of the common stock.

III. PETITIONERS SHOULD BE RELIEVED FROM THE FIVE PER CENT PENALTY FOR THE ALLEGED ONE-DAY DELAY IN FILING THEIR RETURNS.

The taxpayers' returns were due under their extensions of time on June 1, 1937. The return of one of the taxpayers as introduced in evidence (Respondent's Exhibit "B") bears the Collector's stamp:

"FILED

6/2 37

Collector of Internal Rev.

First District Calif.

Deputy SWAS"

Mr. Swan testified (Tr. p. 124) that his general recollection was that the returns were taken by him to the Internal Revenue Office in the Post Office Building, Oakland, and an attempt made to file them on June 1, 1937, the due date; that they were slipped through the slot in a door in the office late in the afternoon of that day.

The rule is that the Board will relieve from penalty for late filing if there is "reasonable cause" for the

delay. Such reasonable cause is defined in *Pearsoll v. Commissioner*, 29 B. T. A. 747, as "such cause as would prompt an ordinary intelligent and prudent businessman to have so acted under similar circumstances." An ordinary intelligent and prudent businessman in this community knows that all city and county offices are open until 5:00 o'clock as required by law.

California Political Code, sections 1030 and 4312.

He knows that the United States Post Office (in the same building as the United States Collector of Internal Revenue) is open until 6:00 o'clock.

Under such circumstances it was not unreasonable to expect that the office of the Collector of Internal Revenue would remain open until 5:00 o'clock and that a taxpayer might with propriety file his return up until that hour. Finding the office after 4:00 o'clock locked, it was not unreasonable to slip the returns with a check for the amount of tax shown due on Mrs. Swan's return through the slot in the door provided for that purpose.

This was such cause as would prompt an ordinary intelligent and prudent businessman to have so acted under similar circumstances.

Counsel for the Government cite only four authorities none of which is in point. The first two—*United States v. Lombardo*, 241 U. S. 73 and *Poyner v. Commissioner*, 81 Fed. (2d) 521, merely hold that placing in the mail is not filing. Of course it is not. Incident to such determination the Court states that a paper

is filed when it is delivered to the proper officer and "received". But this does not mean that a paper can be prevented from being filed when it is left in the proper office merely because the deputy in charge has locked his door at 4:00 o'clock in the afternoon.

The other two cases cited by counsel for the Government are inapplicable.

In *J. K. McAlpine Land & D. Co. v. Commissioner*, 126 Fed. (2d) 163, no evidence whatever was offered to excuse the delayed filing which was many months delinquent. See the case in 43 B. T. A. 520.

In *West Side Tennis Club v. Commissioner*, 111 Fed. (2d) 6, the only justification offered was that the taxpayer "believed" it was exempt.

In the present case the taxpayers made a valid effort to file their returns by leaving them at the appropriate office on the afternoon of the due date. The returns are not made delinquent merely because the Collector later stamped them with the succeeding day's date.

CONCLUSION.

The Government is entitled to prevail because.

1. It is endeavoring to treat the transaction as a present cancellation of indebtedness in 1936 when, as a matter of fact, the stock had been freed from the burden of all but \$200,000.00 of the debt in 1930.

2. It is treating the Bank of America transaction as a cancellation of debt when, as a matter of fact, it

was a purchase at pledgee's sale for the full amount of the debt.

3. It is attempting unfairly to tax "negative income"—to levy a tax upon heavily involved taxpayers merely because their burden of debt has been somewhat lightened by the voluntary act of their creditors.

4. It is attempting to tax unearned and unrealized income.

5. It is levying a double tax on the same income, first, by including it as part of the unrealized income incident to the cancellation of indebtedness; second, by including it as a part of the profit on the sale of the stock just freed from such indebtedness.

6. It is allocating the cost between preferred and common stock when, as a matter of fact, the common stock had no fair market value. *Illegally allocated*

7. It levied a penalty for late filing merely because the deputy collector stamped the returns the day after the taxpayers had left the returns under the Collector's door.

Dated, Oakland, California,
October 9, 1942.

Respectfully submitted,

ROBERT W. MACDONALD,

*Attorney for Petitioners-
Appellants.*

ROBINSON, PRICE & MACDONALD,
Of Counsel.



No. 10087

**In the United States Circuit Court of Appeals
for the Ninth Circuit**

MINNIE L. WHITTHORNE AND EVA WHITTHORNE, EX-
ECUTRICES OF THE ESTATE OF W. R. WHITTHORNE,
DECEASED, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

and

SHERWOOD SWAN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISIONS OF THE UNITED
STATES BOARD OF TAX APPEALS

SUPPLEMENTAL BRIEF FOR THE RESPONDENT

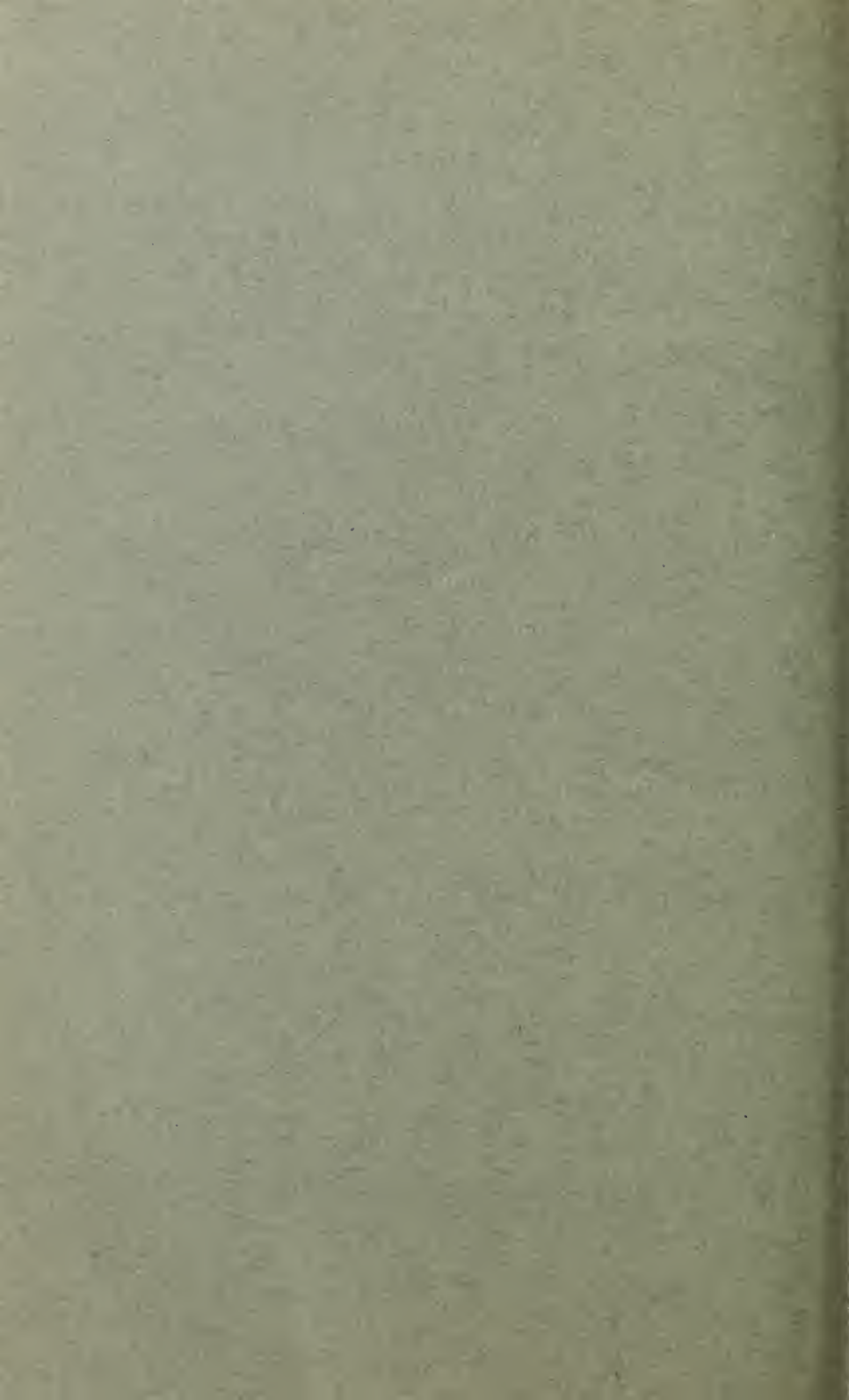
SAMUEL O. CLARK, Jr.,
Assistant Attorney General.

SEWALL KEY,
MURIEL S. PAUL,
*Special Assistants to the
Attorney General.*

FILED

DEC 27 1944

PAUL P. O'BRIEN,
CLERK



INDEX

CITATIONS

Cases:	Page
<i>Bogardus v. Commissioner</i> , 302 U. S. 34.....	3
<i>Helvering v. A. L. Killian Co.</i> , 128 F. 2d 433.....	3
<i>Helvering v. Amer. Dental Co.</i> , 318 U. S. 322.....	2
<i>Hirsch v. Commissioner</i> , 115 F. 2d 656.....	3
<i>Noel v. Parrott</i> , 15 F. 2d 669.....	3
<i>Old Colony Tr. Co. v. Commissioner</i> , 279 U. S. 716.....	3
<i>United States v. Kirby Lumber Co.</i> , 284 U. S. 1.....	1, 4

(I)

In the United States Circuit Court of Appeals for the Ninth Circuit

No. 10087

MINNIE L. WHITTHORNE AND EVA WHITTHORNE, EX-
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COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISIONS OF THE UNITED
STATES BOARD OF TAX APPEALS

SUPPLEMENTAL BRIEF FOR THE RESPONDENT

The Board of Tax Appeals held that the taxpayers' settlement of their debts to the Bank of America and to the Central National Bank of Oakland came within the rule of *United States v. Kirby Lumber Co.*, 284 U. S. 1, the purport of which is that a solvent corporation which purchases its own obligations for less than their face amount realizes taxable income in the amount of that difference.

Subsequent to the filing of briefs upon taxpayers' appeal to this Court, the Supreme Court on March 1, 1943, rendered its decision in *Helvering v. Amer. Dental Co.*, 318 U. S. 322. Thereafter, and on April 13, 1943, the taxpayers filed a supplemental memorandum in this Court wherein it is contended that the decision in the *Amer. Dental* case is determinative of the instant case and that no taxable income was realized through the settlement of taxpayers' indebtedness. In that case the taxpayer owed past due bills for merchandise. The indebtedness was represented by interest-bearing notes. The creditor agreed to cancel the accrued interest. The taxpayer also owed back rent and its landlord accepted approximately one-half of the amount due in full payment. The Supreme Court held that the amounts cancelled by its creditors constituted gifts to the taxpayer.

It is the Government's position that the facts do not bring this case within the doctrine of the *Amer. Dental* case and that it is governed by the *Kirby Lumber* case as set out in our original brief (pp. 10-20). At the outset we emphasize two things. One, that the Supreme Court did not overrule its decision in the *Kirby Lumber* case, and, two, that the present taxpayers' indebtedness is not of the type dealt with in the *Amer. Dental* case. In the latter, the Court dealt only with the particular indebtedness cancelled in that case and, in effect, differentiated it from other types of debt cancellation. Specifically it said (pp. 327-328):

In fields closely related to the cancellation of indebtedness which we are considering here, this Court has treated gains in net assets as

income. In *United States v. Kirby Lumber Co.*, 284 U. S. 1, the taxpayer purchased its own bonds at a discount. It was held taxable on the increase in net assets which resulted. * * * Forfeiture or surrender of a lease by which the lessor gains property or money makes such gain taxable. *Helvering v. Bruun*, 309 U. S. 461; * * *.

The Court continued to illustrate the various types of debt reductions by referring to the "narrow line" between taxable bonuses and tax free gifts. *Bogardus v. Commissioner*, 302 U. S. 34; *Noel v. Parrott*, 15 F. 2d 669 (C. C. A. 4th), as approved in *Old Colony Trust Co. v. Commissioner*, 279 U. S. 716, 730. It pointed out that where the indebtedness has represented the purchase price of property, a partial forgiveness has been treated as a readjustment of the contract rather than a gain. (*Hirsch v. Commissioner*, 115 F. 2d 656 (C. C. A. 7th); *Helvering v. A. L. Killian Co.*, 128 F. 2d 433 (C. C. A. 8th)) and that where a stockholder gratuitously forgives the corporation's debt to himself, the transaction has long been recognized by the Treasury as a contribution to the capital of the corporation.

The Court concluded that the voluntary act of the creditors in releasing part of the rent arrears and the interest on notes given for merchandise claims (p. 330)—

is more akin to a reduction of sales price than to financial betterment through the purchase by a debtor of its bonds in an arm's-length transaction.

It is submitted that there is no language in the Supreme Court's opinion which justifies the conclusion that a release of note indebtedness representing borrowed funds is "akin to a reduction of sale price." On the contrary it is more akin "to financial betterment through the purchase by a debtor of its bonds in an arm's-length transaction", and is clearly within the doctrine of *United States v. Kirby Lumber Co.*, *supra*.

In the *Amer. Dental* case, the Court concluded (p. 331) that the forgiveness of the rent and merchandise claims "was gratuitous, a release of something to the debtor for nothing," and sufficient to make the cancellation there gifts within the statute. While a simple release by a landlord of past due rent and the release by a merchant of his claims for merchandise sold may be purely gratuitous and voluntary, it is difficult to see how the release in the present case could be called gratuitous.

In summary, the situation here is that the taxpayers jointly owed the Central Bank \$165,081.32 and Swan separately owed that bank \$20,000. Those notes were secured by 500 shares of Sherwood Swan & Company, Ltd.; 2,000 shares of Swan's (another corporation); 1,725 shares of Wasserman-Gattmann Company; and an insurance policy on the life of Swan. (R. 80.)

They jointly were indebted to the Bank of America in the principal amount of \$89,066.33, and Swan was separately indebted in the principal amount of \$65,000. These notes were secured by 500 shares of Sherwood Swan & Company, Ltd., 2,071 shares of Hale Brothers

Realty Company, 2,000 shares of Swan's (another corporation), and 1,725 shares of Wasserman-Gattman Company. (R. 80.)

In order to pay a portion of their obligations to the two banks the taxpayers were obliged to refinance their company.¹ A third bank, the Anglo-California Bank, agreed to advance \$175,000 on condition that it obtain the 1,000 shares of Sherwood Swan common stock as collateral. (R. 80-81.) The taxpayers were then to issue new stock in exchange for the old common. The arrangement also encompassed the agreement of an underwriting firm to purchase \$175,000 worth of the new stock and to furnish collateral to the Anglo-American Bank for the shares so contracted for. (R. 81-82.) The bank was to release the remaining shares of new stock to the taxpayers when the underwriter completed payment of the purchase price (\$175,000) of the shares sold to it. (R. 83.)

On the day that the taxpayers obtained the loan of \$175,000 from the Anglo-American Bank, \$75,000 was turned over to the receivers of the Central Bank, together with the taxpayers' joint note for \$20,000. The 500 shares of Sherwood Swan stock were then released to the Anglo-American Bank, the transaction being approved by the court. (R. 79-80.) The following day \$100,000 was turned over to the Bank of

¹ The vice-president of the Central Bank testified (R. 120) that he recalled numerous discussions urging Swan to endeavor to finance the market in order to pay on that bank's indebtedness. These discussions apparently occurred as far back as 1930 to 1933. (R. 119.)

America together with Hale Brothers Realty Company stock worth \$34,564.69.²

It seems wholly unreasonable to contend that this transaction, which involved not only the taxpayers and the two creditor banks but also the Anglo-American Bank and an underwriting firm, was not an "arm's-length transaction." The settlement of the notes was interdependent with the other steps in the entire arrangement. The banks' surrender of taxpayers' notes for less than their face value has no element of gratuity. The plain fact is that the Central Bank's receiver and the Bank of America bargained for the best payment obtainable. Furthermore, the Bank of America received outright certain stock worth \$34,564.69 which it had theretofore held as collateral and the Central Bank received a joint note of \$20,000 in place of Swan's separate note for that amount.

We submit that this constituted consideration for the amounts of debt cancelled, even in a technical sense, but in any event it is sufficient to distinguish the transaction from the purely gratuitous and voluntary release of the past due obligations involved in the *Amer. Dental* case, *supra*. Certainly it would be a strange assumption that the banks owing a fiduciary duty to their depositors, had either motive or intent to confer a gift of their funds upon the taxpayers,

² This settlement was handled by means of a sale at which the taxpayers bid in the 500 shares of Sherwood Swan stock for \$100,000 and the bank bid in the other securities, pledged with it, at \$96,073.14. The entire worth of the latter was \$34,564.69. (R. 80.)

particularly in the case of the Central Bank whose settlement was approved by the District Court.

As stated above, the Supreme Court did not discard the principle established by its former decisions, that the retirement of a corporate loan obligation by payment of less than the amount borrowed results in the realization of taxable income. The present obligations were no different, in substance and from the tax viewpoint, from the obligations which were cancelled in the *Kirby Lumber* case, *supra*, and decisions following it. It is clear that unless the doctrine of the *Kirby Lumber* case and the applicable regulations are reduced to a nullity, the gain realized by taxpayers here cannot be considered a tax exempt gift. We submit that the decision in the *Amer. Dental* case does not affect the contentions made in our original brief as to the applicability of the *Kirby Lumber* case and that for reasons previously advanced in that brief the taxpayers realized income in the amount determined by the Board.

CONCLUSION

The Board of Tax Appeals' decision should be affirmed as to all issues for the reasons presented in our original brief.

Respectfully submitted,

SAMUEL O. CLARK, Jr.,
Assistant Attorney General.

SEWALL KEY,

MURIEL S. PAUL,

Special Assistants to the Attorney General.

AUGUST, 1944.

United States
Circuit Court of Appeals
For the Ninth Circuit.

MASON B. PATTEN,

Appellant,

vs.

J. CHARLES DENNIS, United States Attorney
in and for the Western District of Washington,

Appellee.

Transcript of Record

Upon Appeal from the District Court of the United States
for the Western District of Washington,
Northern Division

FILED

NOV - 3 1942

PAUL P. O'BRIEN,
CLERK

United States
Circuit Court of Appeals
For the Ninth Circuit.

MASON B. PATTEN,

Appellant,

vs.

J. CHARLES DENNIS, United States Attorney
in and for the Western District of Washington,

Appellee.

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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

	Page
Amendment to Original Pleading.....	16
Appeal:	
Certificate of Clerk to Record on.....	21
Designation of Portions of Record to Be Contained in Record on (DC).....	18
Designation of Additional Portions of Rec- ords and Proceedings on (DC).....	19
Notice of	17
Statement of Points and Designation of Parts of Record to Be Printed on (CCA)	31
Certificate of Clerk to Transcript of Record on Appeal	21
Designation of Additional Portions of Records and Proceedings, Appellee's (DC).....	19
Designation of Parts of Record to Be Printed (CCA)	31
Designation of Portions of Record to Be Con- tained in Record on Appeal, Appellant's, (DC)	18

Index	Page
Hearing on Plaintiff's Petition for Rehearing.	15
Motion for Leave to Verify Petition and Further Amend Petition.....	23
Motion to Circuit Court of Appeals for Clarification of Issues Involved.....	24
Motion to Dismiss.....	6
Continued to April 6, 1942.....	6
Motion to Deny.....	7
Order Signed on.....	8
Order Sustaining	13
Petition for Rehearing of.....	14
Motion to Join Additional Parties as Defendant	27
Motion to Order Defendants to Produce in This Court File of This Case in Their Possession.	28
Motion to Strike Appellant's Motion for Leave to Verify Petition and Further Amend Petition	29
Motion to Strike Appellee's Motion to Strike Appellant's Motion for Leave to Verify Petition and Further Amend Petition.....	26
Names and Addresses of Attorneys.....	1
Narrative of Proceedings Before the Court, Portion of	20
Notice of Appeal.....	17

Index**Page**

Order on Motion to Dismiss Signed.....	8
Order Sustaining Motion to Dismiss.....	13
Original Pleading, Amendment to.....	16
Petition for Rehearing of Motion to Dismiss..	14
Hearing on	15
Petition for Show Cause Action.....	1
Statements of Points and Designation of Parts of Record to Be Printed (CCA).....	31

NAMES AND ADDRESSES OF COUNSEL

MR. MASON B. PATTEN, Pro Se,
107 Main Street
Seattle, Washington

MR. J. CHARLES DENNIS,
1012 U. S. Court House,
Seattle, Washington
Attorney for Appellee.

MR. GERALD D. HILE,
1012 U. S. Court House,
Seattle, Washington
Attorney for Appellee.

United States District Court in and for
the Western District of the State of
Washington

File No. 462

MASON B. PATTEN

vs.

J. CHARLES DENNIS, U. S. Attorney in and
for the Western District.

PETITION FOR SHOW CAUSE ACTION

To the Honorable Judge of the United States
District Court in and for the state of Washington
in Seattle, Washington. I, Mason B. Patten, a

citizen of the State of Washington, and a citizen of the United States and the Western District of the State of Washington, do petition that you shall cause to appear before this court, and show cause why a warrant should not be issued (against one William B. Smith, Vaughn Bogard, Albert Larsen for the violation of Section 51 and section 126 (criminal Codes Title 18) Codes of Federal Regulation of the United States) the district attorney of the U. S. in and for the western District of the state of Washington,

Whereas the said William B. Smith, Vaughn Bogard, Albert Larsen did on or about the 21 of December 1940 enter into a conspiracy to violate Section 51 and Section 126 (Criminal Code Title 18) U. S. Code of Federal regulations with intent to injure the right of Mason B. Patten.

Whereas the U. S. District Attorney has refused to bring action against the said William B. Smith, Vaughn Bogard, Albert E. Larsen, I Mason B. Patten do petition that this Court shall order a Warrant issued against one William B. Smith, Vaughn Bogard, Albert E. Larsen now in the Western district of the State of Washington and employee of the Federal Government on a federal Military Reservation in the [1*] State of Washington, Puget Sound Navy Yard.

That this court shall appoint a special prosecutor to prosecute to the end this action provided

*Page numbering appearing at foot of page of original certified Transcript of Record.

by the constitution of the U. S. of America and Bill of rights and laws of the Congress of the United States of America.

Whereas the said William B. Smith did on or about the 21 of December 1940 approach one Vaughn Bogard and Albert Larsen and solicit help in preventing Mason B. Patten from carrying through a request for investigation of malicious practice against Mason B. Patten, with full knowledge that by making statement in writing of the said Mason B. Patten by the said Vaughn Bogard and Albert E. Larsen would place Mason B. Patten in disrepute and subject to ridicule before his superior officers. That Vaughn Bogard and Albert Larsen did make statement in writing to the Chief of Yard, Puget Sound Navy Yard in regard to said Mason B. Patten which were false and with intent to violate the provisions of Section 51 and Section 126 (Criminal code Section 19, title 18, Conspiracy to injure person in exercise of civil right: If two or more persons conspire to injure, oppress, threaten or intimidate any citizen in the free exercise or enjoyment of any right or privilege secured by the constitution or laws of the United States, or because of his so exercising the same * * * with intent to prevent or hinder his free enjoyment of any right or privilege so secured, They shall be fined not more than \$5,000 and imprisoned for not more than ten years. Shall moreover be thereafter ineligible for any office, or place of honor, or trust created by the constitution or laws of the

United States (R. S. Section 5508, Mar. 4, 1909, G. 321, P. 19, 35 Stat. 1092). Section 232 (criminal Code Section 126) Title 18. Subornation of perjury: Whoever shall procure another to commit any perjury is guilty of subornation of perjury, and [2] punishable as in Section 231 of this title prescribed. (R. S. Section 5393, Mar. 4, 1909, C. 321, Page 126, 35 Stat. 1111).

Therefore Mason B. Patten as plaintiff does pray that this court shall order that this cause shall be prosecuted in accordance with paragraphs of the Federal Codes Annotated, Section 24, amended Page 449, Section 4, Title 28 which states District Courts shall have original Jurisdiction, Subdivision 12, of all suits authorized by law to be brought by any person for the recovery of damages on account of any injury to the person or loss where the loss sustained is conjectural and uncertain and cannot be accurately determined, the jury may award damages as by competent evidence plaintiff appears to have sustained. (section 546, U. S. C. (Criminal Code, Section 340). Section 2, article 3, Judicial department, federal code, title 28, Page 167).

The judicial power shall extend to all cases in law and equity, arising under the Constitution, the laws of the United States or which shall be made under their power, to controversies between two or between citizens thereof,

Whereas the Plaintiff Mason B. Patten does complain of unlawful and irreparable damage has been

done to the person of the *said by* so doing of unlawful acts, and prays for relief from such injury sustained.

MASON B. PATTEN
107 Main St.
Seattle, Washington

State of Washington
County of King—ss.

AFFIDAVIT

I, Mason B. Patten being first duly sworn upon oath, depose and say, that I am the petitioner in the above named action, that I have read the foregoing action and believe the same to be true.

.....

Subscribed and Sworn to before me this.....
day of January, 1942,

.....

[3]

Notary Public in and for the State of Washington
residing at

[Endorsed]: Filed January 22, 1942. [4]

[Title of Court and Cause.]

MOTION TO DISMISS

Comes Now the defendant in the above-entitled cause and moves that the Court dismiss the above-entitled action for the following reasons:

I.

That the Court has no jurisdiction over the subject matter.

II.

That plaintiff's pleading fails to state a claim upon which relief can be granted and particularly insofar as defendant herein is concerned.

J. CHARLES DENNIS

United States Attorney

G. D. HILE

Assistant United States
Attorney.

[Endorsed]: Filed Mar. 20, 1942. [5]

[Title of Court and Cause.]

MOTION TO DISMISS

CONTINUED TO APRIL 6, 1942.

Now on this 30th day of March, 1942, this cause comes on before the Court on defendant's motion to dismiss; defendant's motion re misjoinder of parties; defendant's motion to make more definite and certain. Plaintiff Mason B. Patten appears for

himself and G. D. Hile, Assistant United States Attorney appears for the defendant. Argument is had. Attorney Charles Osborn volunteers advice to plaintiff and these matters are now all continued to April 6, 1942.

Journal No. 29,
Page 790 [6]

[Title of District Court and Cause.]

MOTION TO DENY MOTION OF
DEFENDANT TO DISMISS

Comes Now the Plaintiff in the above entitled action and moves the Court that Petition of defendant be denied on the following reason:

I.

That Defendant has failed to follow Procedure as set forth in Federal Rules of Civil Procedure by filing a Motion to Dismiss and Motion to make more definite and certain, by not following Procedure as outlined in Rule 12 (E) which states, "Before responding to a pleading within twenty (20) days after the service of the pleading against him, a party may move for a more definite statement.

II.

That Defendant by motion to make more definite and certain has placed himself under the jurisdiction of the Court, as stated in *Johnson & Gould v.*

Joseph Schlitz Brewing Co., D. C. Tenn. 1939, 28 F. Supp. 650. "The rule permitting demand for Bill of Particulars contemplates use by a party who is in Court. He is either in Court or out of Court. He cannot assume the position that he questions the jurisdiction of his person and yet undertake to require plaintiff to make a more particular statement of his grounds of action. [7]

III.

That Plaintiff has sufficiently stated the claim for which relief can be granted as denial of due process of law by defendant and equal protection of law.

/s/ MASON B. PATTEN

Plaintiff

107 Main Street,
Seattle, Washington.

[Endorsed]: Filed Mar. 30, 1942. [8]

[Title of Court and Cause.]

ORDER ON MOTION TO DISMISS SIGNED
(Minute entry)

Now on this 6th day of April, 1942, this cause comes on before the Court for further hearing on defendant's motions to dismiss; re misjoinder of parties and to make more definite and certain. Attorney Chas. F. Osborn appears for the plaintiff and Gerald D. Hile, Asst. U. S. Attorney appears

for the defendants. Attorney Osborn advises the Court and withdraws as attorney. Plaintiff Patten consents thereto. Both sides address the Court. Letter of March 19, 1941 is filed. Letter from Dennis filed, substitution of copy may be made later, and carbon copy of letter to Dennis dated March 25, 1941 is filed, substitution may be made later. Motion to dismiss is granted on each of the two grounds set forth in motion to dismiss. Later: Written order of dismissal signed in presence of the party plaintiff and attorney for defendants. Plaintiff excepts thereto. Exception allowed.

Journal No. 29

Page 811 [9]

(Copy)

Address reply to
The Secretary of the Navy and
refer to initials and No.

SOSED*4-Wm

LL/P19-1(410127)

Navy Department
Washington

March 19, 1941

My dear Mr. Patten:

Referance is made to your letter of March 6, 1941, addressed to the Secretary of the Navy, in which you make further request for investigation of your discharge from the position of Classified laborer at the Puget Sound Navy Yard, effective

January 15, 1941, for unsatisfactory services during probation, and again allege discrimination and perjury in connection with the statements which resulted in your dismissal.

The records show that you were fully informed by the Departments letter of February 27, 1941, of the reasons for your discharge. The Department is satisfied that the Commandant was justified in the action taken and that you were given every consideration to which you were entitled under the Civil Service rules.

Therefore, the Department cannot consistently take any further action in the premises.

Sincerely yours,

CHARLES PIOZET,

Director of Personnel.

Mr. Mason B. Patten,
105 Columbia Street,
Seattle, Washington.

[Endorsed]: Filed April 6, 1942. [10]

Department of Justice
United States Attorney

Terms of Court—Western District of Washington
Seattle, Washington
February 21, 1941

Northern Division

Seattle:

First Tuesdays May and November

Bellingham:

First Tuesdays April and October

Southern Division

Tacoma:

First Tuesdays February and July

Mr. Mason B. Patten

105 Columbia Street

Seattle, Washington

Sir:

This will acknowledge receipt of your letter of February 20th with respect to your discharge from the Puget Sound Navy Yard, Bremerton, Washington.

You are advised that from an examination of the documents submitted with the said letter, this is a matter that should be handled by the Naval authorities pursuant to the provisions of their request for you to show cause why your services should not have been discontinued.

Respectfully,

J. CHARLES DENNIS

United States Attorney

FAP:ih

[Endorsed]: Filed April 6, 1942. [11]

Seattle, Washington

March 25, 1941

U. S. District Attorney
Western District of Washington
Seattle, Washington

Sir:

I have not had a reply from my last two letters to your office in regard to my charges of Perjury and discrimination. Also the letter addressed to the U. S. Attorney General of the United States in care of you, what action has been or is contemplated I wish to be informed.

Yours truly,

MASON B. PATTEN.

[Endorsed]: Filed Apr. 6, 1942. [12]

United States District Court
Western District of Washington
Northern Division

No. 462

MASON B. PATTEN,

Plaintiff,

vs.

J. CHARLES DENNIS, United States Attorney
in and for the Western District,
Defendant.

ORDER SUSTAINING MOTION
TO DISMISS

This matter having regularly come on for hearing before the above-entitled Court on the 6th day of April, 1942, and the plaintiff being present in person and the defendant being represented by G. D. Hile, Assistant United States Attorney, and the Court having heard the argument of the defendant in support of the defendant's motion to dismiss heretofore filed herein and having heard fully the said Mason B. Patten, plaintiff, in opposition to said motion to dismiss, and the Court being of the opinion, after hearing the argument aforesaid, that said motion to dismiss is well taken, It Is Therefore

Ordered, Adjudged and Decreed That the motion to dismiss in the above-entitled case be, and it is hereby sustained, and said action is hereby dis-

missed, for the reason that the Court has no jurisdiction over the subject matter, and for the further reason that plaintiff's pleading fails to state a claim upon which relief can be granted and particularly insofar as the defendant herein is concerned.

Done in Open Court this 6th day of April, 1942.

JOHN C. BOWEN

Judge.

Approved & presented

By G. D. HILE,

Asst. U. S. Atty.

Approved as to form:

MASON B. PATTEN,

Plaintiff.

[Endorsed]: Filed April 6, 1942. [13]

[Title of District Court and Cause.]

PETITION FOR REHEARING OF
MOTION TO DISMISS

Comes Now the plaintiff and states that an appeal should be granted plaintiff in the above entitled cause, and a new trial ordered on the following grounds.

I.

(Entire paragraph eliminated.)

4/13/42

M.B.P.

II.

That this Court has jurisdiction over subject matter, to which plaintiff takes exception.

III.

That defendant did fail to follow proper procedure in responding to plaintiff's pleading.

IV.

That plaintiff did state a claim upon which relief can be granted and particularly insofar as the defendant herein is concerned.

MASON B. PATTEN,
Plaintiff.

[Endorsed]: Filed Apr. 9, 1942. [14]

[Title of Court and Cause.]

HEARING ON PLAINTIFF'S PETITION
FOR REHEARING

Now on this 13th day of April, 1942, this cause comes on before the Court for hearing on plaintiff's appeal from order sustaining motion to dismiss. Mason B. Patten appears per se and G. D. Hile, Assistant United States Attorney, appears for the Government. The title of this document is now changed on request of plaintiff to Petition for Rehearing of Motion to Dismiss. This matter is argued. Petition is denied. This cause also comes

on before the Court on motion to amend original pleadings. The proposed amendment is now granted for plaintiff's benefit nunc pro tunc as of the time immediately before the motion to dismiss was heard, this being done so that plaintiff will derive any benefit therefrom to which he may be entitled. Mr. Hile, Assistant U. S. Attorney, now again advises the plaintiff Patten that he is privileged to appear before the next Grand Jury for the purpose of presenting the matter of his grievance and that the Government will afford him every opportunity to do so.

Journal No. 29

Page 834. [15]

[Title of District Court and Cause.]

AMENDMENT TO
ORIGINAL PLEADING

Comes Now the plaintiff and petitions this Court to amend original pleadings by the following paragraphs:

I.

That Defendant by refusal to bring action upon information of Plaintiff became liable to Plaintiff for damages.

II.

That Plaintiff be granted relief from injury sustained by action of the above named Defendants,

whereas, unless Plaintiff is allowed recourse to prosecute said action, the injury sustained to the person of Plaintiff will be irreparable.

III.

That this Court has jurisdiction over subject matter by virtue of authority of the Constitution of the United States, and laws of the United States as passed by the Congress of the United States.

MASON B. PATTEN,
Plaintiff.

[Endorsed]: Filed Apr. 9, 1942. [16]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that plaintiff in the above entitled cause appeals from Order of Judge, sustaining motion to dismiss as ordered, adjudged and decreed in open Court the 6th day of April, 1942.

MASON B. PATTEN,
Plaintiff.

[Endorsed]: Filed May 26, 1942. [17]

[Title of District Court and Cause.]

DESIGNATION OF PORTIONS OF RECORD
TO BE CONTAINED IN RECORD ON
APPEAL

Appellant designates the following portions of records to be contained in record on appeal in the above entitled action:

1. Complaint
2. Motion to Dismiss
3. Plaintiff's motion to deny motion of defendant to dismiss
4. Order granting motion of defendant to dismiss
5. Plaintiff's motion for new trial
6. Plaintiff's amendment to original complaint
7. Copies of letters to District Attorney relative to subject
8. Notice of appeal
9. This designation
10. Designation by appellee of additional matters to be included in the record.

11. The appellant states that the points upon which the appellant intends to rely on appeal are:

1. That this court has jurisdiction of subject matter by virtue of Section 485, Judicial Code, U.S.C.A.
2. That plaintiff did state a claim upon which relief can be granted, and particularly insofar as plaintiff herein is concerned.

MASON B. PATTEN

Received a copy of the within.....
this 9th day of June, 1942.

J. CHARLES DENNIS,
Defendant.

[Endorsed]: Filed June 9, 1942. [18]

[Title of District Court and Cause.]

APPELLEE'S DESIGNATION OF ADDI-
TIONAL PORTIONS OF RECORDS AND
PROCEEDINGS

Appellee designates the following additional por-
tions of the records and proceedings to be contained
in the record on appeal in the above entitled action:

1. Letter of February 21, 1941, from J. Charles
Dennis.
2. Letter of March 19, 1941, from Charles
Piozet, Director of Personnel.
3. Clerk's journal entry of March 30, 1942.
4. Clerk's original minute entry of April 6,
1942.
5. Clerk's journal entry of April 13, 1942.
6. Proceedings concerning designation on
March 30, 1942, of Charles F. Osborn, Attorney at
Law, by the Court to advise appellant.
7. Proceedings of April 6, 1942, re statement of
Charles F. Osborn to the Court and his withdrawal

as attorney, and statements of appellant to the Court during the proceedings of said date.

J. CHARLES DENNIS

United States Attorney.

G. D. HILE

Assistant United States
Attorney.

[Endorsed]: Filed Jun. 19, 1942. [19]

NARRATIVE OF PROCEEDINGS BEFORE
THE COURT REFERRED TO IN PARAGRAPHS
NUMBERED 6 and 7

On March 30, 1942, the matter came on regularly before the Court on appellee's motion to dismiss the complaint.

Appellant advised the Court that he would proceed without counsel and thereupon argument on appellee's motion [20] to dismiss appellant's complaint ensued, both sides being fully heard. Appellant in the course of his argument against the motion to dismiss stated that his object in bringing the action was to attempt to obtain reinstatement in his former employment at the Bremerton Navy Yard and offered the letter of March 19, 1942, from Charles Piozet, Director of Personnel, and the letter of February 21, 1941, from J. Charles Dennis, both of which were filed by the Court with consent of appellant.

After hearing both sides fully, the Court sustained appellee's motion to dismiss on both the grounds stated in said motion.

After such ruling appellant confessed to the Court in open Court that appellant's complaint did not state a claim upon which relief could be granted and particularly insofar as appellee was concerned, but appellant did insist that the Court had erred in concluding that the Court had no jurisdiction of the subject matter.

Thereafter appellant was allowed an exception to the Court's ruling in sustaining appellee's motion to dismiss. [21]

[Title of District Court and Cause.]

CERTIFICATE OF CLERK
TO RECORD ON APPEAL

United States of America
Western District of Washington—ss.

I, Judson W. Shorett, Clerk of the United States District Court for the Western District of Washington, do hereby certify that the foregoing type-written transcript of record, consisting of pages numbered from 1 to 21, inclusive, is a full, true and complete copy of so much of the record, papers and other proceedings in the above and foregoing entitled cause, as is required by designations of counsel filed and shown herein, as the same remain of record and on file in my office at Seattle, and that the same constitute the record on appeal here-

in from the Order Sustaining Motion to Dismiss entered by the court on April 6, 1942, to the United States Circuit Court of Appeals for the Ninth Circuit.

I further certify that the following is a true and correct statement of all expenses, costs, fees and charges incurred in my office by or on behalf of the appellant for making record, certificate or return to the United States Circuit Court of Appeals for the Ninth Circuit, to wit: [22]

Clerk's fees (Act Feb. 11, 1925) for making record, certificate, or return, 34 folios at 15c	\$ 5.10
Appeal fee	5.00
Certificate of Clerk to Transcript.....	.50
	<hr/>
	10.60

I hereby certify that the above amount has been paid to me by the appellant.

In Witness Whereof, I have hereunto set my hand and affixed the official seal of said District Court at Seattle, in said District, this 29th day of June, 1942.

[Seal]

JUDSON W. SHORETT,

Clerk,

United States District Court,
Western District of Wash-
ington,

By TRUMAN EGGER,
Chief Deputy.

[Endorsed]: Filed Sept. 24, 1942. [23]

United States Circuit Court of Appeals
Ninth Circuit

No. 10,265

No. 462 D.C.

MASON B. PATTEN,

Plaintiff,

vs.

J. CHARLES DENNIS, United States attorney in
and for the Western District,

Defendant.

MOTION FOR LEAVE TO VERIFY PETI-
TION AND FURTHER AMEND PETI-
TION

I.

Comes now the plaintiff in the above named cause
and petitions for leave of this court to verify and
amend the original petition to read "Petition for
Quo Warranto".

II.

Comes now the plaintiff and petitions for leave
to further amend said complaint to read as fol-
lows:

This cause is brought in Quo Warranto by virtue
of law of Congress (March 3, 1901, C 854, section
1540, 31 Statute 1420, which states:

"Title 28, Judicial Code, U.S.C.A. Section
377c Institution on refusal of Attorney General
and District Attorney. If the Attorney General

and the District Attorney shall refuse to institute a quo warranto proceeding on the request of a person ininterested, such person may apply to the court for verified petition for leave to have such writ issued, * * *"

MASON B. PATTEN,
107 Main St.,
Seattle, Washington
Plaintiff.

[Endorsed]: Received June 22, 1942.

[Title of Circuit Court of Appeals and Cause.]

MOTION TO CIRCUIT COURT OF APPEALS
FOR CLARIFICATION OF ISSUES IN-
VOLVED

Comes now the appellant and states to the Circuit Court of appeals that the issues involved in the above entitled cause have been so disturbed that clarification is needed:

On or about January 18, 1941, Plaintiff complained to Defendant G. D. Hile of personal injury caused to his person by unlawful acts of the following persons: Mr. William B. Smith, Vaughn Bogard, Albert E. Larsen, by conspiracy and perjury and asked that defendant G. D. Hile take action against the said persons. Defendant G. D. Hile refused to bring action on the grounds that such acts were not under the jurisdiction of his

office; that upon showing to defendant G. D. Hile that such acts were directly under his office the defendant G. D. Hile stated he was not going to take any action.

Whereupon Plaintiff wrote a letter to United States District Attorney, J. Charles Dennis, co-defendant, and district attorney answered as shown in record of court proceedings. Whereupon Plaintiff again wrote to J. Charles Dennis, defendant herein, asking for action in his behalf; defendant did not answer this letter; Plaintiff addressed a letter to Attorney General in care of defendant J. Charles Dennis, defendant, which has never been sent to Attorney General. Plaintiff wrote a letter to United States District Attorney, J. Charles Dennis, in Tacoma, Washington after unsuccessful attempts to see defendant J. Charles Dennis at his Seattle office. The defendant has refused to answer such correspondence in regard to the case and every attempt to see said defendant has been averted.

Plaintiff has requested United States Attorney General for action in his behalf directly and as of date no action has been taken by said U. S. Attorney General.

The question presented in the District Court before The Honorable John C. Bowen is, was the District Attorney by refusal to bring action violating the U. S. C. A. Title 28, Judicial Code, Section 485, from whose judgment of the issues involved warrant the issue of a quo warranto writ

in favor of Plaintiff against the named persons in the original petition for show cause action.

MASON B. PATTEN,
Appellant
107 Main Street
Seattle, Washington.

[Endorsed]: Recd. June 29, 1942.

[Title of Circuit Court of Appeals and Cause.]

MOTION TO STRIKE APPELLEE'S MOTION
TO STRIKE APPELLANT'S MOTION
FOR LEAVE TO VERIFY PETITION
AND FURTHER AMEND PETITION

Appellant moves the Court to deny appellee's motion to strike appellant's motion for leave to verify petition and further amend petition, for the following reasons:

1. That all papers and pleadings on file in said cause have direct bearing and show what relief is warranted to appellant.
2. That said motion was made by appellant to show good faith by willingness to put statements under oath, having the effect of making oath.
3. That this Court has jurisdiction to grant the relief requested.

MASON B. PATTEN
107 Main Street
Seattle, Washington

Authority:

Title 28, U.S.C.A., Section 371, Par. 2 (Judicial Code) Section 256 Title 28, U.S.C.A., Section 377, (Judicial Code) Sec. 262 (A.B.C.) Act of Congress (Mar. 3, 1901, C. 854, Sec. 1538, 31 Stat. 1419; June 25, 1936, C. 804, 49 Stat. 1921)

Minnesota & Ontario Paper Co. v. Molyneaux (C.C.A. Minn. 1934) 70F 545

Newman v. U.S.ExRel, Frizzell (1915) 35 S.Ct. 881, 238 U.S. 537, 59 L. Ed. 1446 Reversing, 1915, 43 App. D.C. 53

Rule 81, Federal Rules of Civil Procedure following 723 C. See note advisory committee under said Rule 81.

Davis v. F. W. Woolworth Co. 54 F. 2d 366.

[Endorsed]: Rec'd June 29, 1942.

[Title of Circuit Court of Appeals and Cause.]

MOTION TO JOIN ADDITIONAL
PARTIES AS DEFENDANT

I.

Comes now the appellant in the above named cause and joins one G. D. Hile, Assistant United States District Attorney, as co-defendant with the above named defendant J. Charles Dennis, as equally responsible for this action before The Honorable Court, on the following grounds:

1. Plaintiff had supplied G. D. Hile with information concerning violation of laws of the United States, and G. D. Hile urged Plaintiff to take said case into the State Court with full knowledge that the State Court had no jurisdiction of the subject matter.

MASON B. PATTEN

107 Main St.,
Seattle, Washington,
Plaintiff.

[Endorsed]: Received June 29, 1942.

[Title of Circuit Court of Appeals and Cause.]

MOTION TO ORDER DEFENDANTS TO PRO-
DUCE IN THIS COURT FILE OF THIS
CASE IN THEIR POSSESSION

I.

Comes now the appellant in the above named cause and makes motion that this Court shall order the above named defendants to produce in this Court the following designated papers and file in their possession:

(1) Copies of letters given to Defendant G. D. Hile from U. S. Navy Yard, Bremerton, Washington, relative to charges against Plaintiff.

(2) Copies of letters addressed to J. Charles Dennis, District Attorney, from Plaintiff, and answers to Plaintiff.

(3) Original letter addressed to U. S. Attorney General in care of J. Charles Dennis, District Attorney, Seattle, Washington.

(4) Letter addressed to Foreman of U. S. Grand Jury, Seattle, Washington, Registered letter No. 1212, delivered to foreman on January 5, 1942.

MASON B. PATTEN,
107 Main Street
Seattle, Washington
Plaintiff.

[Endorsed]: Received June 29, 1942.

[Title of Circuit Court of Appeals and Cause.]

MOTION TO STRIKE APPELLANT'S MOTION FOR LEAVE TO VERIFY PETITION AND FURTHER AMEND PETITION

Appellee moves the Court to strike appellant's motion for leave to verify petition and further amend petition for the following reasons:

1. That none of the pleadings or papers on file in said cause including said motion warrant the relief requested.

2. That said motion is frivolous.

3. That this Court has no jurisdiction to grant said motion.

J. CHARLES DENNIS

United States Attorney.

G. D. HILE

Assistant United States
Attorney.

Attorneys for Appelle.

Authority:

Title 28, U.S.C.A., Sec. 377a, b, c.

[Endorsed]: Received Jul. 3, 1942.

[Endorsed]: No. 10265. United States Circuit Court of Appeals for the Ninth Circuit. Mason B. Patten, Appellant, vs. J. Charles Dennis, United States Attorney in and for the Western District of Washington, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the Western District of Washington, Northern Division.

Filed September 24, 1942.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

In the United States Circuit Court of Appeals
for the Ninth District

No. 10265

MASON B. PATTEN,

Appellant,

vs.

J. CHARLES DENNIS, United States Attorney
in and for the Western District,

Appellee.

STATEMENT OF POINTS AND DESIGNA-
TION OF PARTS OF RECORD TO BE
PRINTED

Comes now the appellant in the above entitled cause and files the following statement of points relied upon by appellant for reversal of judgment entered in the said cause by district judge of United States District Court at Seattle, Washington in and for the Western District, Northern Division of the State of Washington, on April 6, 1942, and a designation of parts of record which appellant thinks necessary for the consideration of points relied upon for reversal of judgment.

1. That defendant failed to respond to pleadings in accordance with federal rules of procedure.

2. That the District Court has jurisdiction of the subject matter.

3. That appellant did state a claim upon which relief can be granted, and particularly insofar as the defendant herein is concerned.

Designation of Parts of Record to Be Printed

1. Motion for leave to verify petition and further amend petition.
2. Motion to join additional parties as defendants.
3. Motion to order defendants to produce in this Court file of this case in their possession.
4. From certified record from District Court Clerk of the above entitled cause, the following:
 1. Complaint.
 2. Motion to Dismiss by defendant.
 3. Plaintiff's motion to deny motion of defendant to dismiss.
 4. Order granting motion of defendant to dismiss.
 5. Plaintiff's motion for rehearing of motion to dismiss.
 6. Copies of letters to District Attorney relative to subject.
 7. Designation by Appellee (3) Clerk's original minute entry of April 6, 1942.
 8. Designation by appellee Clerk's journal entry of April 13, 1942.
 9. Defendant's narrative of proceedings before the Court, lines 3 and 4, page 1; line 31, page 1, to end of page 2.
 10. Letter of February 21, 1941 from J. Charles Dennis.
 11. Motion for clarification of issues involved to Circuit Court of Appeals.

12. Defendant's motion to strike appellant's motion for leave to verify and further amend petition.

13. Motion to strike appellee's motion to strike appellant's motion for leave to verify and further amend petition.

14. This designation.

15. Additional designation by Appellee.

MASON B. PATTEN,
Appellant.

Received a copy of the within Statement etc. this
2 day of Oct. 1942.

J. CHARLES DENNIS,
Appellee.

[Endorsed]: Filed Oct. 3, 1942.

United States
Circuit Court of Appeals
For the Ninth Circuit

MASON B. PATTEN,

Appellant,

—vs.—

J. CHARLES DENNIS, United States Attorney in and for
the Western District of Washington.

Appellee.

UPON APPEAL FROM THE DISTRICT COURT
OF THE UNITED STATES FOR THE
WESTERN DISTRICT OF WASHINGTON,
NORTHERN DIVISION.

BRIEF OF APPELLANT

Pilot Press, Seattle

FILED

NOV 30 1942

PAUL P. O'BRIEN,
CLERK

United States
Circuit Court of Appeals
For the Ninth Circuit

MASON B. PATTEN,

Appellant,

—vs.—

J. CHARLES DENNIS, United States Attorney in and for
the Western District of Washington.

Appellee.

UPON APPEAL FROM THE DISTRICT COURT
OF THE UNITED STATES FOR THE
WESTERN DISTRICT OF WASHINGTON,
NORTHERN DIVISION.

BRIEF OF APPELLANT

INDEX

	<i>Page</i>
Jurisdictional Statement	1-2
Statement of Case	2-4
Argument	5-9
Appendix	10-19
U. S. Codes Cited:	
Title 8, U.S.C.A., Section 49, Chapter 3.....	10
Title 18, U.S.C.A., Section 51, (Criminal Code 19) ..	2-12
Title 18, U.S.C.A., Section 88, (Criminal Code, Section 37)	5-11
Title 18, U.S.C.A., Section 232 (Criminal Code 126) ..	5
Title 18, U.S.C.A., Section 451 (Criminal Code) ..	15-17
Title 18, U.S.C.A., Section 468 (Criminal Code 298) ..	17
Title 18, U.S.C.A., Section 546 (Criminal Code 340) ..	5
Title 28, U.S.C.A., Section 41 (Judicial Code, Section 24, Amended) (Subdivision 12)	13
Title 28, U.S.C.A., Section 225 (Judicial Code 128, Amended)	10
Title 28, U.S.C.A., Section 371 (Judicial Code, Section 256)	1
Title 28, U.S.C.A., Section 377 (a) (Judicial Code, Section 262)	8-14
Title 28, U.S.C.A., Section 377 (c) (Judicial Code, Section 262)	14
Title 28, U.S.C.A., Section 485 (Judicial Code)	5
Title 28, U.S.C.A., Section 777 (Judicial Code) ..	7-8-14
Title 34, C.F.R., Chapter 1, Navy	15
Federal Rules of Procedure Title 28, following 723C	6

INDEX

	<i>Page</i>
Rule 4	5
Rule 12 (B) (C) (E) (G)	5-6
Cases Cited:	
United States Cases Cited:	
Federal Life Ins. Co. v. Holod, 28 F. Supp. 270.....	16
Griffin v. U. S., 299 F. 437	18
In re Bieler, 295 F. 78	11
Johnson & Gould v. Schlitz Brewing Co., 28 F. Supp. 650	17
McAllister v. Sloan, 81 F. Supp. 707	8-11
U. S. Ex rel Hassell v. Matthews, 27 Fed. 2d 137.....	18-19
Newman v. U. S. Ex rel Frizzell, 238 U.S. 537.....	8
Washington Case:	
Murray v. Gerrick & Company, 172 Wash. 369, 20 P. 2d 591	18

No. 10265

**United States
Circuit Court of Appeals
For the Ninth Circuit**

MASON B. PATTEN,

Appellant,

—vs.—

J. CHARLES DENNIS, United States Attorney in and for
the Western District of Washington.

Appellee.

UPON APPEAL FROM THE DISTRICT COURT
OF THE UNITED STATES FOR THE
WESTERN DISTRICT OF WASHINGTON,
NORTHERN DIVISION.

BRIEF OF APPELLANT

Statement as to Jurisdiction on Appeal:

MAY IT PLEASE THE COURT:

Apepllant, in support of the jurisdiction of this
Court to review the above entitled case on appeal
presents:

This Court has jurisdiction of appeal under the fol-
lowing sections of the Judicial Code as amended:

Title 28, U.S.C.A., Section 371 (Judicial Code 256, Amended, Chapter 10)

Title 28, U.S.C.A., Section 225 (Judicial Code 128, Amended)

Title 28, U.S.C.A., Judicial Code, Section 41, Subdivision 12) (Section 24, Amended)

Title 28, U.S.C.A., Section 377C (Judicial Code, Section 262).

Jurisdictional Amount Involved:

Suit at Law for injury to person of Plaintiff.

Amount in controversy, irreparable injury.

Judgment for relief from injury sustained.

STATEMENT OF CASE

This is an appeal from order of Judge in the District Court of the United States in the Western District of the State of Washington (P. 13) dismissing an action against J. Charles Dennis, United States Attorney to Show Cause (p. 1) why a warrant should not be issued against one William B. Smith, Vaughn Bogard, Albert E. Larsen for conspiracy to violate title 18, section 51 and section 126 of the Criminal Codes (P. 2) with intent to injure the right of Mason B. Patten. The U. S. Attorney upon information of Mason B. Patten (P. 11) had refused to bring action against said William B. Smith, Vaughn Bogard, Albert E. Larsen, (P. 2).

On the 6th day of April, 1942, this Cause came on to be heard (P. 8) and (P. 9) on defendants motion to dismiss, re misjoinder of parties and to make more definite and certain, motion (P. 13) to dismiss was granted on each of the two grounds set forth to dismiss. Plaintiff excepted thereto. Exception was allowed.

On April 9, 1942, plaintiff petitioned the Court for rehearing of motion to dismiss (P. 14). Hearing was heard on Plaintiff's petition for rehearing on 13th of April, 1942 (P. 15). Also motion to amend original pleading (P. 16) which was granted.

On May 26, 1942, Notice of Appeal was filed (P. 17). On June 9, 1942 Designation of Portions of record was filed with clerk of District Court and a copy served on Defendant 9th day of June 1942. On June 19, 1942 Appellee filed additional designation of portions of records and (P. 19) proceedings, together with narrative of proceedings (P. 20 and P. 21). Thereupon Clerk of District Court prepared a transcript of record (P. 21) and was filed Sept. 24, 1942.

On June 22, 1942 Plaintiff makes motion for leave to this Court, Court of Appeals, (P. 23) in which Plaintiff petitions this Court to verify and amend the original petition for show cause to petition for *quo warranto*.

On June 29 a motion was presented by Plaintiff clarifying the (P. 24) issue in the above the entitled cause to the Circuit Court of Appeals also on same date motion was made by appellant to strike appellee's motion (P. 26) to deny appellant's motion for leave to verify petition and further amend petition (P. 29, 30).

Motion is made to this Court to join as additional parties as defendant one G. D. Hile, Assistant United States District Attorney (P. 27).

Motion is made also to order defendants to produce in this (P. 28) Court file of this case in their possession.

(P. 31) Is statement of points and designation of parts of record to be printed which was filed Oct. 3, 1942.

This Court is asked to cause to be issued a *quo warranto* in accordance with Rules of Federal Regulation as passed by Congress and any special relief to which appellant is entitled to and due for such injury to the person of appellant.

ARGUMENT OF CASE

(1) It is unlawful to conspire to commit any conspiracy against any provisions title 18, (Criminal Codes) U. S. C. A.

Title 18, section 88, (Criminal Code, Section 37)
Conspiracy to Commit Crime against the United States.

(2) It is the duty of the District Attorney of the United States to prosecute violations of the Laws of U. S.

Title 28, section 485, Judicial Code, U. S. C. A.
Griffin v. U. S., 299 F. 437

U. S. ex rel Hassel v. Matthews 27 F. 2nd 137

Title 8, U. S. C. A., Section 49, Chapter 3.

(3) The method of proceeding to institute action:
A civil action is commenced by filing a complaint with Court (P. 1) and by delivery to officer or agency a copy of summons and complaint to such officer. Said summons was issued by clerk of court with copy of complaint upon filing.

(4) District courts shall have original jurisdiction of all (P. 4) suits authorized by law to be brought by any person for the recovery of damages on account of any injury to the person, or loss.

Title 28 (Judicial Code, section 24) section 41, subdivision 12.

Title 18, section 546, U. S. C. (Criminal Code, section 340.

(5) Response to pleadings, if any:
Rule 12, B. C. E. G., Title 28, Federal Rules of Procedure following 723c.

Johnson & Gould v. Joseph Schilt Brewing Co.,
D. C. 1939, 28 F. Supp. 650.

Federal Life Insurance Co. v. Holod, D. C. Penn, 1939, 28 F. Supp. 270.

Appellee fails to follow procedure as set forth in (Rule 12E) Federal Rules of Procedures (P. 6):

Motion is made to dismiss action, re misjoinder of parties, motion to make more definite and certain as response to pleading. Motions which are based wholly or in part on other than Jurisdiction Grounds contribute a general appearance.

Johnson & Gould v. Joseph Schiltz Brewing Co., D. C. 1939, 28 F. Supp. 650.

(6) (1) Appellee claims appellant fails to state a claim upon which (P. 6) relief could be granted—insofar as defendant is concerned. Inspection of pleadings, page 1 to 3 of Record (and original pleading lines 7 to 13, lines 23 to 31, line 32, page 1 to line 3 page 2.) shows what relief could be granted.

(2) That District Court has no jurisdiction of subject matter (P. 6).

Title 34, U. S. C. A. Navy, par. 1.1515.
48 Statute 152, U. S. C. 468, (Par. 1, 3).

Murray v. Joe Gerrick & Co., et al., 172 Wash. 369.

Section 468 (Criminal Code, Section 289, Title 18, U. S. C. A.

Title 18, Section 451, Chapter 11, (Section 272, Criminal Code, Par. 3)

Title 28, Section 41, (Judicial Code, Section 24, Amended). Par. 2, 12.

(7) Upon hearing District Court Dismissed Action against defendant on the grounds contained in order of dismissal (P. 6).

(8) Plaintiff petitioned for rehearing of motion to dismiss (P. 14) and filed amendment to original pleadings (P. 16) upon hearing on plaintiff's petition for rehearing (P. 14, 15) and amendment to original pleading petition (P. 16) petition for rehearing is denied (P. 15).

(9) May 26, 1942 notice of appeal is filed from order of Judge (P. 17) appeal was taken in time.

Appellants filed with clerk of District Court designation of portions of record (P. 18) in record of appeal.

(10) Certificate of clerk to record on appeal (P. 21) filed Sept. 24, 1942 (P. 22).

(12) Motion is made in this Court for leave to verify petition (P. 23) and further amend petition (P. 23).

U. S. C. A., Title 28, Judicial Code, section 371, amended, section 256.

U. S. C. A. Title 18, section 451 (Criminal Code 272).

U. S. C. A. Title 28, section 777, note 122, page 90, re Bieler (C. C. A. N. Y. 1923) 295 F. 78. (Page 22, U. S. C. A. Cumulative Pocket Part, paragraph 112, 115) (119, Page 23),

MacAllister v. Sloan (C. C. A. Ark. 1936, 81 F. Supp. 707.

U. S. C. A. Title 28, Section 377, (A), (C)
(Judicial Code) section 262.

Newman v. U. S. Ex Rel Frizzell, (1915) 35 S. Ct. 881, 238 U. S. 537, 59 F. Ed. 1446 Reversing, 1915, 43 App. D. C. 53

(13) Motion is made to this Court to join additional defendants (P. 27) in the above entitled cause. Also motion is made to order the defendants to produce in this Court papers on file in possession of said defendants (P. 28).

(14) Appellee makes motion to strike appellant's motion for leave to verify petition and further amend petition and motion to produce in this Court papers in their possession (P. 29). Appellant so moves this Court to deny said motion.

Therefore appellant on appeal prays that this Court shall issue, against said persons in line 18 to 23 of original pleadings (Page 1, 2) a *quo warranto* in accordance with Title 28, U. S. C. A., section 377 (Judicial Code) Sec. 262 (A. C) and Section 777, note 1, section 377 B, U. S. C. A. in *Newman v. U. S. Ex Rel Frizzell*, 1915, 238 U. S. 537, 43 App. D. C. 53. Also any special relief which this Court should find is due to appellant for injury to the person as defined

in the laws of the U. S. of America, against appellees
in this cause of action.

MASON B. PATTEN, *Appellant*.

APPENDIX

Title 8, Section 49, Chapter 3, U.S.C.A.

Prosecution of Violation of Certain Laws:

The district attorney, marshals, the commissioners appointed by the district and territorial Courts, with power to arrest, imprison, or bail offenders, and every officer who is especially empowered by the President, are authorized and required, at the expense of the United States, to institute prosecutions against all persons violating any of the provisions of Section 51 of this title or of Sections 5506-5516 and 5518-5538 of the Revised Statutes, and to cause such persons to be arrested, and imprisoned or bailed, for trial before the Court of the United States or the territorial Court having cognizance of the offense (R. S. Section 1982).

Title 28, U.S.C.A. Section 225 (Judicial Code 128, Amended) Appellate Jurisdiction.

(a) Review of final decisions:

The Circuit Court of Appeals shall have appellate jurisdiction to review by appeal—final decisions.

(1) In the District Courts, in all cases save where a direct review may be had in the Supreme Court. U.S.C.A., Title 28 (Judicial Codes, Section 777) Chapter 18, Note 122, page 90.

Defects in Forms, Amendments (on appeal):

APPENDIX

In *re Bieler* (C.C.A. N.Y. 1923) 295 F. 78.

Generally the allegations of a complaint may be amended to make the original statements more definite and precise, the test being whether the proposed amendment is a defferent matter, another subject of the controversy, or the same matter more fully or differently said.

Page 22, pocket supplement, par. 112, on a pepal, appellate Court may regard pleading as amended to conform to proof. (*McCallister v. Sloan* (C.C.A. Ark. 1936) 81 F. Supp. 707)

119: Amended complaint, making no change in facts relied on for recovery, but merely altering remedy, or result of facts alleged in original complaint, states no different cause of action and is proper (*McAllister v. Sloan* (C.C.A. Ark. 1936) 81 F. Supp. 707.

Title 18, Section 88 (Criminal Code, Section 37)

Conspiracy to commit offense against United States:

If two or more persons conspire either to commit any offense against the United States, and one or more of such parties do any act to effect the object of the conspiracy, each of the parties to such conspiracy shall be fined not more than \$10,000 or imprisoned not more than two years or both.

APPENDIX

U.S.C.A., Title 18 (Section 51 Criminal Code, Section 19) Conspiracy to injure person in exercise of civil rights:

If two or more persons conspire to injure, oppress, threaten or intimidate any citizen in the free exercise or enjoyment of any right or privilege secured by the United States, or because of his so exercising the same—with intent to prevent or hinder his free enjoyment of any right or privilege so secured, they shall be fined not more than \$5,000 and imprisoned for not more than ten years and shall moreover be thereafter ineligible for any office, or place of honor, or trust created by the Constitution or Laws of the United States. (R.S. Section 5508, Mar. 4, 1909, C. 321, p. 19, 35 Stat. 1092).

Title 18, U.S.C.A., Section 232 (Criminal Code, Section 126)

Subornation of Perjury:

Whoever shall procure another to commit any perjury is guilty of subornation of Perjury and punishable as in Section 231 of this title prescribed. (R.S. Section 5393, Mar. 4, 1909, C. 321, Page 126, 35 Stat.) Title 18, Section 546, U.S.C.A. (Criminal Code, Section 340)

APPENDIX

Jurisdiction of District Courts:

The crimes and offenses defined herein in this title shall be cognizable in the district court of the United States as described in Section 41 of Title 28, Judicial Code (Section 24, amended, p. 449, Federal Codes Annotated) :

Section 41, Title 28, the District Courts shall have original jurisdiction, subdivision 12, of all suits authorized by law to be brought by any person for the recovery of damages on account of any injury to the person or loss.

Where the loss sustained is conjectural and uncertain and cannot be accurately determined, the jury may award such damages as by competent evidence plaintiff appears to have sustained.

Subdivision 12.

Suits Covering Civil Rights: Twelfth.

Of all suits authorized by law to be brought by any person for recovery of damages on account of any injury to his person or property, of the deprivation of any right or privilege of a citizen of the United States, by any act done in furtherance of any conspiracy in Section 47 of Title 8.

APPENDIX

Title 28, U.S.C.A. (Section 377) (Judicial Code, Section 262) (A.C.) Act of Congress (Mar. 3, 1901, C. 854, Section 1538, 31 Stat. 1419; June 25, 1936, 49 Stat. 1921.)

(a) A *quo warranto* may be issued from the District Court of the United States for the District of Columbia in the name of the United States, as amended by the Act of June 25, 1936, C. 804, 49 Statute 1921—from the District Court of the United States for the District of Columbia.

(1) Against a person who usurps—unlawfully exercises within the district a franchise or public office, civil or military, and said proceedings shall be deemed a civil action.

(2) This section and 777B and 777C, in proper cases, instituted by proper officers or persons, may be enforceable against national officers of the United States. The sections are therefore to be treated as general laws of the United States, not as mere local laws of the District. (Newman v. U. S. Ex Rel Frizzell, 1915, 35 S. Ct. 881, 238 U.S. 537, 59 L. Ed. 1446 reversing 1915, 43 App. D.C. 53.)

(c) Same institution on refusal of attorney general and district attorney. If the attorney general and district attorney shall refuse to institute a *quo warranto*

APPENDIX

proceeding on request of a person interested, such person may apply to the Court for verified petition for leave to have such writ issued, and if in the opinion of the Court reasons set forth in said petition are sufficient in law, the said writ shall be allowed to be issued by any attorney, in the name of the United States, on the relation of the interested person, on his compliance with the conditions prescribed in Section 232 of this title as to security of costs. (Mar. 3, 1901, C. 854)

Title 18, U.S.C.A., Chapter 11, Section 451 (Criminal Code, Section 272, Par. 3)

When committed on any lands reserved or acquired for the exclusive or con-current jurisdiction thereof, or any place purchased or other acquired by consent of legislature of the State in which same shall be, for the erection of a fort, magazine arsenal, dockyard, or other needful building.

C.F.R., Title 34—Navy. Chapter 1. Department of the Navy. 1.1515—Observance of Laws.

(a) The Commandant or Commanding Officer of any Naval Station or other naval reservation situated within the limits of any state, territory, or District, which has been acquired by the United States through purchase or otherwise for Naval purposes, and over

APPENDIX

which the United States has exclusive jurisdiction shall require all persons on or within the limits of such stations or reservations strictly to observe all existing federal laws, and all laws of the state, territory or district wherein such place is located which were in force on March 4, 1909.

(b) Persons not in the Naval service who commit an offense on or within the limits of such station or reservation, which offenses are not made penal under the laws of the United States, but which, if committed within the jurisdiction of the State, territory or district in which such station or reservation is situated, would be subject to punishment in accordance with the laws of the state, territory or district concerned, existing March 4, 1909, shall be deemed guilty of a like offense and subject to the punishment. Such persons are subject, for such offense, to trial by the United States District Court for the district in which the Naval station is situated. (Section 28935 Stat. 1145, 48 Stat. 152 U.S.C. 468) (Par. 1, 3)

Federal Life Insurance Co. v. Holod, D. C. Pa. 1939, 28 F. Supp. 270.

A defendant desiring more particular or definite information than was set forth in complaint should not have filed a motion to dismiss, but should have re-

APPENDIX

sorted to means provided by the rules for securing that information.

Johnson & Gould v. Schlitz Brewing Company, 28 F. Supp. 650.

The decision of the judge of the court said: But under the provisions of the rules indicated, a defendant may join a motion questioning the jurisdiction of the person with a motion to dismiss because of merit of the complaint. But the provisions are not the same Rule 12E providing for a more definite statement or bill of particulars. So far as this case is concerned the time for filing such motion was before responding to a pleading. Irrespective of the rules of civil procedure, motions which are based wholly or in part on other than jurisdictional grounds constitute a general appearance.

Title 18, Section 468 (Criminal Code, 289)

Laws of states adopted for punishing unlawful acts:

Whoever, within the territorial limits of any state, or district, but within or upon any of the places now existing, described in Section 451 of this title, shall do not omit the doing of any act or thing not made penal by any Act of Congress, but which if committed or omitted within the jurisdiction of the state, terri-

APPENDIX

tory or district in which such place is situated, by the laws thereof now in force would be penal, shall be deemed guilty of a like offense and be subject to a like punishment. R.S. 5391, July 7, 1898, C. 576, Section 2, 30 Stat. 717, Mar. 4, 1909, C. 321, Section 289, 35 Stat. 1145.)

Murray v. Gerrick & Company, 172 Wash. 369, 20 P. 2d. 201. Excerpt:

The opinion of Judge Main.

There is nothing in the language of the Federal Act which would indicate an intention on the part of Congress to extend the industrial act over the Navy Yard (which is subject to the exclusive jurisdiction of the United States and within the exterior boundaries of this state).

Griffin v. U.S. 299 F. 437 (C.C.A. Pa. 1924)

The United States attorney and his assistants are officers of the Court upholding quasi-judicial positions, and it is their duty, not only to prosecute the guilty, but also to protect the innocent.

U.S. Ex Rel Hassell v. Mathews, 27 F. 2d. 137:

It was said by District Judge Dickinson: We cannot be too often reminded that every person has thrown

APPENDIX

around him the double protection (1) from unfounded accusation; and (2) from unjust conviction. In the ordinary course of prosecution, it is the duty of prosecuting officers, county magistrates and especially of grand juries to afford this first protection.

The right of protection is not a procedural one but is a substantive right.

IN THE
United States
Circuit Court of Appeals
FOR THE NINTH CIRCUIT

MASON B. PATTEN,

Appellant,

vs.

J. CHARLES DENNIS, United States
Attorney in and for the Western
District of Washington,

Appellee.

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED
STATES FOR THE WESTERN DISTRICT OF WASHINGTON
NORTHERN DIVISION

HONORABLE JOHN C. BOWEN, *Judge*

BRIEF OF APPELLEE

J. CHARLES DENNIS
United States Attorney

G. D. HILE
Assistant United States Attorney
Attorneys for Appellee

OFFICE AND POST OFFICE ADDRESS:
1017 UNITED STATES COURT HOUSE.
SEATTLE, WASHINGTON

FILED

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DEC 20 1942

PAUL P. O'BRIEN,
CLERK

IN THE
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Circuit Court of Appeals
FOR THE NINTH CIRCUIT

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INDEX

	Page
STATEMENT OF THE CASE.....	1
POINTS RELIED UPON	2
I. PLEADING	3
II. COURT HAD NO JURISDICTION.....	3
III. PETITION DID NOT STATE A CAUSE OF ACTION	3
MOTION	4
CONCLUSION	5

RULE CITED

Rule 7(b), Rules of Civil Procedure for the Dis- trict Courts of the United States.....	3
--	---

IN THE
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HONORABLE JOHN C. BOWEN, *Judge*

BRIEF OF APPELLEE

STATEMENT OF THE CASE

Mason B. Patten was a classified laborer at the Puget Sound Navy Yard. He was discharged for inefficiency. Claiming that his discharge was due to

discrimination, he complained to the United States Attorney. The latter wrote him that it was necessary that he contact the Navy Yard (Tr. 11). He did so, and a finding was made by the Navy Yard that his discharge for inefficiency was amply justified and that his charge of discrimination was unfounded.

After receiving this letter, he filed the present petition, which he denominated as a Petition to Show Cause. As near as appellee can determine, the gist of the Petition is that Bogard, Larsen and Smith made a statement in writing to the Chief of Yard, Puget Sound Navy Yard, relative to Patten. That the statements in the letter were false. That because of the same, appellant suffered irreparable damage. His prayer is that appellee (United States District Attorney) appear before the Court and show cause why a warrant should not issue against Smith, Bogard and Larsen.

Appellee filed a motion to dismiss. The motion was granted, and judgment of dismissal entered. The case is here on appeal.

POINTS RELIED UPON

The Points relied upon were three (Tr. 31):

1. That defendant failed to respond to pleadings in accordance with Federal rules of procedure.

2. That the District Court had jurisdiction of the subject matter.

3. That appellant did state a claim upon which relief can be granted, and particularly insofar as the defendant is concerned.

I. PLEADING

Appellee, in response to petition, filed a motion to dismiss. This is proper pleading [Rule 7(b)].

II. COURT HAD NO JURISDICTION

If the action is for pecuniary damages, no diversity of citizenship is alleged, nor the jurisdictional amount.

If against the United States, no statute allows petitioner the right to sue.

III. PETITION DID NOT STATE A CAUSE OF ACTION

All that the petition stated was that Smith approached Bogard and Larsen and solicited help in preventing Patten from carrying through a request for investigation of malicious practice against Patten. That these three men made a statement in writing

to the Chief of Yard, Puget Sound Navy Yard, which statement was false.

The petition is silent as to when the statement in writing was made, or what it contained. If false, as alleged, appellant has a civil remedy against the three men, but not in the Federal Court. These men were not parties to the action.

If a federal offense was involved, appellant had the right to appear before the grand jury, a right which was tendered him (Tr. 16).

MOTION

Appellant has filed a motion in this Court to allow him to verify his petition, and have the same treated as a "Quo Warranto" proceeding.

As stated before, if any criminal violation has been committed by Larsen, Smith or Bogard, the body that has the duty of preferring the charges is the grand jury. Appellant does not allege that he has been prevented from appearing before the grand jury. He couldn't. He was given that privilege, appeared and testified. The grand jury disposed of his grievance in the same way as the Naval authorities, refusing to bring in a true bill.

CONCLUSION

The action being entirely without merit, the ruling of the District Court was correct, and the judgment of dismissal should be affirmed.

Respectfully submitted,

J. CHARLES DENNIS
United States Attorney

G. D. HILE
Assistant United States Attorney
Attorneys for Appellee

No. 10265

**United States
Circuit Court of Appeals
For the Ninth Circuit**

MASON B. PATTEN,

Appellant,

—vs.—

J. CHARLES DENNIS, United States Attorney in and for
the Western District of Washington.

Appellee.

UPON APPEAL FROM THE DISTRICT COURT
OF THE UNITED STATES FOR THE
WESTERN DISTRICT OF WASHINGTON,
NORTHERN DIVISION

REPLY BRIEF OF APPELLANT

FILED

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PAUL P. O'BRIEN,
CLERK

**United States
Circuit Court of Appeals
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MASON B. PATTEN,

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INDEX

	<i>Page</i>
Restatement of Case	1-3
Points Relied Upon—	
1. Response to Pleading	3
2. Court has Jurisdiction	3
3. Petition does state a cause of action	4
Motion	4
Rule cited 12E. Rules of Federal Procedure for the Courts of United States	3

CASES CITED

Burkhardt v. U. S. 13 F. 2d 841.....	2
Coates v. U. S. 59 F. 2d 173.....	2, 3, 10
D. C. Conn. 1925, 6 F. 2d 937 (Reversed C. C. A. 13 F. 2d 433 and affirmed Maul v. U. S. 47 S. Ct. 735, 274 U. S. 501, 71 L. Ed. 1171).....	3, 9
Davis v. F. W. Woolworth 54 Fed. 366.....	7
Erdman v. Mitchell 56 Atl. 331, 207 Pa. 79.....	3, 4, 6
Rocky Mountain Bell Telephone Company v. Montana A. F. L.	3, 4, 7
Vann v. Union Central Life Insurance Company, 191 P. 175, 79 Okl. 17	5, 8
D. C. Tex. U. S. v. Gilliland, 35 F. Supp. 181.....	4, 10
Ruling Case Law Vol. 5, Page 1068, Section 8.....	9
Ruling Case Law Vol. 5, Page 1068, Section 14.....	9
Ruling Case Law Vol. 5. Page 1090, Section 41.....	9
U. S. Codes Cited:	
U.S.C.A. Title 8, Section 49,	4
U.S.C.A. Title 28, Section 485, Judicial Code.....	7

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Appellee.

UPON APPEAL FROM THE DISTRICT COURT
OF THE UNITED STATES FOR THE
WESTERN DISTRICT OF WASHINGTON,
NORTHERN DIVISION

REPLY BRIEF OF APPELLANT

RESTATEMENT OF CASE

District Attorney states that Mason B. Patten was fired for inefficiency which fact is immaterial to cause as presented to this Court. This action is brought against said appellee for refusal to bring action on his behalf upon information of criminal acts against the laws of the United States as passed by Congress, causing irreparable injury to the person of the appellant by such unlawful acts. (Tr. 3)

(Tr. 24) is motion of clarification of issues to this Court. This the district attorney knows is what this action is about as can be shown if motion of appellee is granted. (Tr. 28). This petition was filed upon unsuccessful attempts to prevail upon U. S. District Attorney to bring action in his behalf (Tr. 25) and U. S. Attorney General. (Tr. 25)

Letter of March 19, 1942 was presented to judge of Court as to the injury to the reputation of appellant by the unlawful acts of William B. Smith, Vaughn Bogard, Albert E. Larsen, by making the false statements which I have offered to prove as false to the Navy Department and refused the opportunity to do so. The United States District Attorney has resisted any action on appellant's part to prove his allegation of perjury and discrimination up to and including the date of August 13, 1941. Also the charge is made against G. D. Hile, Assistant District Attorney, of failing, as a continuing part of the conspiracy hereinbefore alleged and complained of. *Burkhardt v. U. S.* 13 F. 2d 841; *Coates v. U. S.* 59 F. 2d 173.

APPELLEE'S POINTS RELIED UPON WERE:

1. That appellee filed a motion to dismiss, as proper pleading quoting (Rule B)
2. Court had no jurisdiction.
3. Petition did not state a cause of action.

I.

RESPONSE TO PLEADING

In response to pleading Apellee joined with his motion to dismiss, misjoinder of persons, motion to make more definite and certain which is not proper pleading. (Rule 12E)

II.

COURT HAS JURISDICTION.

This action is for redress of injury to rights and privileges as secured to appellant by the laws of the United States between a citizen of the United States and officer of the United States by denial of equal protection and due process of law.

Erdman v. Mitchell 56 Atl. 331, 207 Pa. 79,

Coates v. U. S. 59 F. 2d 173

The United States government is not a party to any action brought by a citizen of the United States against another citizen sounding in tort or of a criminal nature. Therefore, this suit is between a citizen of the United States and an officer of the United States.

Rocky Mountain Bell Telephone Company v. Montana, A. F. L. 156 F 821

D. C. Conn. 1925, 6 F. 2d 937, *Maul v. U. S.* 274 U. S. 501.

III.

PETITION DID STATE A CAUSE OF ACTION

Allegation of plaintiff that a conspiracy was formed to violate the laws of the United States as stated:

Erdman v. Mitchell 56 Atl. 331,

Rocky Mountain Bell Telephone v. Montana
A. F. L. 156 F. 821

Volume 5, Ruling Case Law, Page 1068, Section 14,
Volume 5, Ruling Case Page 1090, Section 41

are sufficient to establish the crime as alleged. These men so-named are ancillary to the action at bar.

D. C. Tex. (Criminal Code, Section 37, 18 U. S. C. A., Section 88) Appellant's Brief, page 11. *U. S. v. Gilliland*, 35 F. Supp. 181, U. S. District Attorney is charged by law to bring such charge before a Grand Jury (Brief Appellants, page 10) Title 8, Section 49, Chapter 3, U. S. C. A. Title 28, Section 485, Judicial Code, U. S. C. A. which District Attorney claimed to have tendered to appellant after appellant appealed to this Court (Tr. 28).

MOTION

Appellee has filed a motion in this Court for dismissal of this action. Appellant so moves this Court to deny said motion. Authority:

Vann v. Union Central Life Insurance Company
191 P. 175, 79 Okl. 17.

Motion is made to this Court for review of Grand Jury Proceedings as held in the City of Seattle on Tuesday, August 25, 1942, with the allegation that the hearing was conducted not in the interest of appellant by Assistant U. S. District Attorney G. D. Hill, as biased and prejudicial against plaintiff, who should be a party to this action.

Respectfully submitted,

MASON B. PATTEN,
Appellant.

APPENDIX

Interference with Employment.

Erdman v. Mitchell 207 Pa. 79, 56 Atl. 331

A conspiracy is a combination of two or more persons by some concerted action to accomplish an unlawful purpose. It is unlawful to deprive a mechanic of work by force, threats or intimidation of any kind.

The judge said:

The first article of the Constitution says: That the general great and essential principles of liberty and free government are to be recognized and unalterably established, we declare that all men are born equally free—and have certain inherent and indefeasible rights, among which are those of employing and defending life and liberty, of acquiring, possessing and protecting property and reputation and pursuing their own happiness.—

—Whenever a Court of common pleas can be reached the citizen, three great and essential principles of free government must be recognized and vindicated by that court, and the indefeasible right of liberty must be protected under the common law (judicial power of the court.)

Conspiracy at common law is a confederacy of two or more persons wrongfully to prejudice another in

APPENDIX

his person or character—to obstruct public justice.

Johnanson v. State, 26 N. J. L.

A combination lawful within itself may become a conspiracy when the purpose in view is to ruin or damage another because of his refusal to do some act against his will or judgment.—

—Every man has a right, as between himself and others, to full freedom in disposing of his own labor—, according to his own will, and anyone who invades that right without lawful cause or justification commits a legal wrong, and, if followed by an injury caused in consequence thereof, the one whose right is thus invaded has a legal ground of action for such wrong.

Rocky Mountain Bell Telephone Co. v. Montana,
A. F. L. 156 Federal Reporter, page 821.

Title 28, U. S. C. A. (Judicial Code Section 485)

It shall be the duty of every district attorney to prosecute, in his district, all delinquents for crimes and offense cognizable under the authority of the United States and all civil actions in which the United States is concerned.

Davis v. F. W. Woolworth 54 F 2d 366 (Tr. 27)

(1) (2) A consideration of the questions raised by

APPENDIX

the motion to dismiss would require the same examination of the evidence offered as would a consideration of the appeal, motions to dismiss appeals are not looked upon with favor. *Vann v. Union Central Life Insurance Co.* 79 Okl. 17, 191 P. 175.

Vann v. Union Central Life Ins. Co. 191 p. 175,
79 Okl. 17. (Syllabus by the Court)

(10) Experience, observation, the thoughtful consideration of the subjects through many questions of men by publicists and statesmen, have produced a consensus of opinion throughout the civilized world that the final decision of grave issues should not be left to the Court or Judge who first hears or tries them, however learned, able, wise and impartial he may be, but that those disappointed in the first decision should be permitted to invoke the judgment of other unprejudiced minds upon the righteousness of the conclusions. Motions to dismiss appeals are not looked upon with favor, and unless it clearly appears from the appellant's statements of his own case that the appeal is wholly without merit, or it is manifestly clear from a casual examination of the record that the only point which is a clear and unmixed question of law, fairly and finally settled adversely to plaintiff in error by the decisions of this court, or the court is without juris-

APPENDIX

diction, or the case is moot, a motion to dismiss will not be considered in advance of the date the case comes on regularly to be heard on its merits.

Supreme Court of Okla. June 29, 1920.

Vol. 5 Ruling Case Law, page 1068, Section 8.

An unlawful combination to injure, oppress, threaten and intimidate a citizen of the United States in the free exercise of a right and privilege secured to him by the Constitution and laws of the United States, and because of his having so exercised same, is a conspiracy indictable and punishable under the United States Revised Statutes, *U. S. v. Lancaster*, 44 Fed. 896, 10 L. R. A. 333.

Vol. 5 Ruling Case Law, page 1068, Section 14.

A combination or confederation formed for the purpose of injuring the reputation of a person is a criminal conspiracy.

Vol. 5 Ruling Case Law, page 1090, Section 41.

Accurately speaking, there is no such thing as a civil action for conspiracy. There is an action for damages caused by acts pursuant to a formal conspiracy, but none for the conspiracy alone.

D. C. Conn. 1925, 6 F. 2d 937, (Reversed C. C. A., 13 F. 2d 433 and affirmed *Maul v. U. S.* (47 Ct. 735,

APPENDIX

274 U. S. 501, 71 L. Ed. 1171)

Act by officer in excess of authority is not act of the Government—The underwriter.

Conspiracy:

An indictment for conspiracy need not show that the conspiracy succeeded. But an allegation of commission of any overt act in furtherance therefore is sufficient.

U. S. v. Gilliland et al D. C. Tex. E. D. Texas, Tyler Division Feb. 20, 1940.

C. C. A. Cal. 1932, *Coates v. U. S.* 59 F. 2d 173,

Persons knowing conspiracy to violate law and assisting in any way in furthering unlawful enterprise is guilty.

United States
Circuit Court of Appeals

For the Ninth Circuit.

HILLCONE STEAMSHIP COMPANY, a corporation,
SANTA CRUZ OIL COMPANY, a corporation and
ASSOCIATED INDEMNITY CORPORATION, a corporation,

Appellants,

vs.

ALBERT V. STEFFEN,

Appellee.

Apostles on Appeal

Upon Appeal from the District Court of the United States
for the Southern District of California,
Central Division

FILED

MAR 3 - 1943

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CLERK

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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

Page

Answer of Respondent Warren A. Pillsbury, etc., to Libel in Personam.....	14
Answer to Libel in Personam.....	11
Appeal:	
Assignment of Error.....	111
Certificate of Clerk to Apostles on.....	117
Citation on	115
Costs Bond on.....	106
Counter-Designation of Record on (DC)..	110
Counter-Designation of Record on (CCA)	123
Designation of Parts of Apostles on (DC)	108
Order Allowing	105
Petition for	104
Statement of Points and Designation of Parts of Record on, Appellant's (CCA).	119
Assignments of Error.....	111
Certificate of Clerk to Apostles on Appeal....	117
Certified Record of Warren H. Pillsbury, Dep- uty Commissioner, United States Employees Compensation Commission	19

Index	Page
Answer of Employer or Insurance Carrier to Claim	25
Certification	20
Compensation Order, Rejection of Claim	85
Employee's Claim for Compensation.....	21
Exhibits:	
Memorandum Portion of Check No. 4635, Statement of Account in Full Settlement of Which Payee Has Accepted Santa Cruz Oil Corporation Check	44
Copy of Insurance Cards of Employers	44
Report of C. C. Carroll, D. O., Addressed to Warren H. Pillsbury, March 17, 1941	83
Transcripts of Testimony:	
February 5, 1941.....	27
Testimony of Albert V. Steffen ..	32
March 18, 1941.....	49
Testimony of Fred H. Cordes....	51
April 17, 1941.....	58
Testimony of Albert V. Steffen...	59
—recalled	70
Testimony of Dr. Robert A. Bilafer	62

Index	Page
Citation	115
Costs Bond on Appeal.....	106
Counter-Designation of Record on Appeal (DC)	110
Counter-Designation of Record on Appeal, Appellee's (CCA)	123
Decree	102
Designation of Parts of Apostles on Appeal (DC)	108
Designation of Parts of Record, Appellant's (CCA)	119
Findings of Fact and Conclusions of Law.....	99
Libel in Personam.....	2
Memorandum of Conclusions.....	89
Minute Orders:	
April 14, 1942, Continuing Cause.....	17
May 4, 1942, Setting Cause for Argument and Submission	18
June 10, 1942, Order Cause Stand Submit- ted	88
August 19, 1942, Order re Decree.....	88
Names and Addresses of Proctors.....	1
Objections to Findings of Fact and Conclu- sions of Law	91
Objections to the Proposed Decree.....	96

Index	Page
Order Allowing Appeal.....	105
Petition for Appeal.....	104
Reply to Objections to Findings of Fact and Conclusions of Law.....	92
Reply to Objections to the Proposed Decree..	97
Statement of Points and Designation of Parts of Record, Appellant's (CCA).....	119

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* Page numbering appearing at foot of page of original certified Transcript of Record.

In the District Court of the United States for the
Southern District of California Central, Division.

No. 1790-H

ALBERT V. STEFFEN

Libelant

vs

HILLCONE STEAMSHIP COMPANY, a corporation;
SANTA CRUZ OIL COMPANY, a corporation;
ASSOCIATED INDEMNITY CORPORATION, a corporation, and
WARREN A. PILLSBURY, Deputy Commissioner,
13th Compensation District, U. S. Employees
Compensation Commission,

Respondents

LIBEL IN PERSONAM

(Under the Longshoremen's and
Harbor Workers' Compensation Act)

To the Honorable the Judges of the United States
District Court for the Southern District of
California, Southern Division; In Admiralty
Sitting:

The libel and complaint of Albert V. Steffen, libelant, against Hillcone Steamship Company, a corporation, owner of the Steamship "Prentiss" and Santa Cruz Oil Company, a corporation, charterer, and Associated Indemnity Corporation, a corporation, insurance carrier, and Warren A. Pillsbury,

Deputy Commissioner, 13th Compensation District, U. S. Employees Compensation Commission, Respondents, in a cause of injunctive relief under Section 21 of the Longshoremen's and Harbor Workers' Compensation Act, to recover for rights arising under said Act by an employee, respectfully shows upon information:

ARTICLE I.

That the respondent Santa Cruz Oil Company is a corporation, organized under the laws of the State of California, and among other things is engaged in the ownership of a fishing fleet navigating and fishing the waters of the Pacific Ocean, and was owner pro hac vice of the Steamship "Prentiss" hereinafter mentioned.

ARTICLE II.

That during all the times herein mentioned the respondent Hillcone Steamship Company was and now is a corporation, and was the owner of the Steamship "Prentiss" which during the month of February, 1937, was docked at the dock of the Santa Cruz Oil Company, and said vessel at said time was laid up for purposes of which [2] libelant is not advised.

ARTICLE III.

That during the month of February, 1937, libelant was an able-bodied man, and was in the employ of the respondents Santa Cruz Oil Company and the Hillcone Steamship Company, and was directed by the agents of said companies to perform the duties

of a watchman aboard said steamship "Prentiss" and during said month, the exact date whereof libelant is not able to specifically state, libelant was in the performance of his said duties.

ARTICLE IV.

That during all the times herein mentioned the respondent Associated Indemnity Corporation was and now is an insurance corporation, engaged in the business of writing insurance policies covering employees under the terms of the Longshoremen's and Harbor Workers' Compensation Act, and prior to said month of February, 1937, said respondent had, in consideration of a premium paid by the other respondents, entered into a contract to insure all employees who sustained personal injuries arising out of and in the course of their employment who were employed on the Steamship "Prentiss."

ARTICLE V.

That during the latter part of February, 1937, the respondent employers had provided a means of ingress and egress to the said steamship "Prentiss" from the dock by placing one end of a ladder on a pontoon attached to said steamship and the other end extending to the deck of said steamship, and after libelant had completed his day's work libelant commenced descending said ladder and slipped on said ladder, thereby causing a forcible wrenching of libelant's back and spine, and causing libelant continued disability ever since said day, to and including the filing of this complaint.

ARTICLE VI.

That at the time of said injury the respondents and each of them had notice of said injury and were given notice thereof, [3] and a claim was made to said employer and to the Deputy Commissioner that libelant had sustained an accidental injury arising out of and in the course of his employment.

ARTICLE VII.

That thereafter such proceedings were had in connection with said claim, before the Deputy Commissioner, that on the 22d day of August, 1941, the Deputy Commissioner made an order rejecting said claim which, omitting title, is in words and figures as follows:

“COMPENSATION ORDER

REJECTION OF CLAIM

CASE No. 2739-1

CLAIM No. 1545

Such investigation in respect to the above entitled claim having been made as is considered necessary and a hearing having been duly held in conformity with law, the Deputy Commissioner makes the following:

FINDINGS OF FACT

That during the week of February, 1937, the claimant above named was in the employ of the employer above named, Santa Cruz Oil Company, at Long Beach, in the State of California, in the 13th Compensation District, established under the provisions of the Longshoremen's and

Harbor Workers' Compensation Act, and that the liability of the employer for compensation under said Act was insured by the Associated Indemnity Corporation;

That claimant contends that about said time he sustained injuries to his back by the slipping of a ladder extending from a pontoon to said ship, while he was leaving said ship in the course of his work;

That at said time claimant was employed as a watchman or caretaker on board the S. S. "Prentiss" and had been so employed for more than two years. That said vessel did not go to sea or engage in commerce or navigation at any time during said period. That there was no crew on board during said time. That said vessel had been purchased by the employer with the intention of reconditioning and remodeling her for service in connection with certain fish reduction plants but that the employer eventually sold said vessel without putting her into use in such or any capacity as a vessel. That at the time of said injury said vessel was indefinitely laid up. That claimant's employment as said watchman and caretaker was not maritime in character.

Upon the foregoing facts it is ordered by the Deputy Commissioner that the claim be and it is hereby Rejected for the following reasons:

That claimant's services at the time of his alleged injury [4] was not maritime in character, and claimant does not come within the provisions of

the Longshoremen's and Harbor Workers' Compensation Act.

Given under my hand at San Francisco, California, this 22d day of August, 1941.

WARREN H. PILLSBURY

Deputy Commissioner

13th District

(omitting proof of service)''

That said rejection order was given after several hearings and investigations made by said Deputy Commissioner.

ARTICLE VIII.

That said compensation order is not in accordance with law in the following particulars:

(a) that the Deputy Commissioner made no findings as to the amount of libelant's average earnings for one year immediately preceding the month of February, 1937, and computed the rate of pay that libelant should be entitled to receive and be paid as compensation under said Longshoremen's and Harbor Workers' Compensation Act on account of injuries sustained by libelant during the month of February, 1937;

(b) that the Deputy Commissioner should have found that libelant's work and the service in which libelant was engaged was of a maritime nature and fell within the terms of the Longshoremen's and Harbor Workers' Compensation Act; that all the evidence adduced shows that libelant was injured while leaving the vessel; that said vessel was afloat in navigable waters and was to be subsequently used

by respondents steamship and oil corporations in the taking and reduction of fish from the waters of the Pacific Ocean, and that the hazards of accidental injuries could not be validly covered by state law; that the entire evidence showed that the Steamship "Prentiss" was not a new vessel nor was the vessel capable of being navigated and used and operated as a merchant vessel; said vessel was moored or anchored for the purpose of making certain repairs that were desirable. [5]

ARTICLE IX.

That all of said proceedings before the Deputy Commissioner are contained in a file of the Deputy Commissioner under Claim No. 1545, Case No. 2739-1, together with the testimony of all witnesses taken before the said Deputy Commissioner in connection with libelant's said accident.

ARTICLE X.

That all the evidence taken before the Deputy Commissioner conclusively shows that libelant's claim under said Compensation Act was one of a maritime nature, arising out of and in the course of libelant's employment.

ARTICLE XI.

That the Deputy Commissioner should be required to file with the clerk of this court, at a time to be fixed by the court, a certified copy of all proceedings had before him, together with all exhibits, transcripts of testimony, letters and documents of every nature and description received by said Deputy Commissioner in consideration of said claim.

ARTICLE XII.

That all and singular the premises are true and within the admiralty and maritime jurisdiction of the United States and of this Honorable Court.

ARTICLE XIII.

That libelant's address is U. S. Marine Hospital San Francisco, Calif.

Wherefore libelant prays that a citation in due form of law, according to the course of this Honorable Court, in causes of admiralty and maritime jurisdiction, under the terms of the Longshoremen's and Harbor Workers' Compensation Act, may issue against the respondents Hillcone Steamship Company, a corporation, Santa Cruz Oil Company, a corporation, Associated Indemnity Corporation, a corporation, and Warren A. Pillsbury, Deputy Commissioner, 13th Compensation District, U. S. Employees Compensation Commission, [6] citing him and said corporations to appear and answer all and singular the matters aforesaid, and that said Warren H. Pillsbury be required, and that said citation and monition require, in his said answer to file with the clerk of this court the original and/or a true and correct transcript of all proceedings had before him in connection with the claim of one Albert V. Steffen, libelant herein, to recover and be paid compensation under the provisions of the said Longshoremen's and Harbor Workers' Compensation Act, together with all exhibits introduced at the hearings had upon said claim, and together with all letters, writings and documents of every nature and de-

scription, and that this Honorable Court, after due consideration thereof, may be pleased to decree to the libelant that the said Deputy Commissioner erred in respect to finding that libelant at the time of his said injury was not engaged in a work or service of a maritime character, and was not subject to the Longshoremen's and Harbor Workers' Compensation Act, and erred in rejecting said claim, and that the court will review under the terms of said Act all proceedings had before said Deputy Commissioner, and enter a decree herein in accordance with law, including the amount of compensation payable to libelant, if the same can be determined from said record, and if the same cannot be determined from said record, then that the cause be remanded to the Deputy Commissioner to fix said compensation, and if necessary, to take additional testimony in relation thereto, and that said Deputy Commissioner may also take additional testimony in connection with libelant's claim, if the same becomes necessary, and that libelant may have such other and further relief as to the court may seem meet and just, including libelant's costs and disbursements incurred herein, together with attorney fees to be fixed by the court in connection with the maintenance of this proceeding.

WILLIAM P. LORD and

FONTANA & GOLDSTONE

By A. A. GOLDSTONE

Proctor for Libelant.

[Verified]

[Endorsed]: Filed Sept. 19, 1941. [7]

[Title of District Court and Cause.]

ANSWER TO LIBEL IN PERSONAM

(Under the Longshoremen's and
Harbor Workers' Compensation Act)

To the Honorable the Judges of the United States
District Court for the Southern District of Cali-
fornia, Southern Division; In Admiralty Sit-
ting:

Comes now the respondents, Hillcone Steamship
Company, a corporation, Santa Cruz Oil Company,
a corporation, and Associated Indemnity Corpora-
tion, a corporation, and by way of answer to the
Libel In Personam filed herein admit, deny and al-
lege:

ARTICLE I.

By way of answer to Article I these respondents
admit all of said article.

ARTICLE II.

In answer to Article II these respondents deny
that the Hillcone Steamship Company was the
owner of the Steamship "Prentiss".

These respondents admit that during the month
of February, 1937, and at all other times, said ves-
sel was docked and affirmatively state that said ves-
sel was at all times laid up and out of service per-
manently.

ARTICLE III.

By way of answer to Article III these answering
respondents deny generally and specifically each and

every allegation therein contained and [8] every part and portion thereof.

ARTICLE IV.

By way of answer to Article IV these respondents admit the allegations contained in Article IV.

ARTICLE V.

In answer to Article V these answering respondents deny generally and specifically each and every allegation therein contained and every part and portion thereof.

ARTICLE VI.

In answer to Article VI these answering respondents admit that a claim was made by said libelant to the Deputy Commissioner that said libelant had sustained an accidental injury arising out of and occurring in the course of his employment, and as to the rest and remainder of said article these answering respondents deny generally and specifically each and every allegation therein contained and every part and portion thereof.

ARTICLE VII.

In answer to Article VII these answering respondents admit all of the allegations contained in Article VII.

ARTICLE VIII.

In answer to Article VIII these answering respondents deny that said compensation order made as alleged by Deputy Commissioner is not in accordance with law.

And further deny that the Deputy Commissioner should have found that libelant's work and the services in which libelant was engaged was of a maritime nature and fell within the terms of the Longshoremen's and Harbor Workers' Compensation Act; and deny that the evidence showing that libelant was injured while leaving the vessel; and deny that said vessel was afloat and in navigable waters and was to be subsequently used by respondents steamship and oil corporation in the taking and reduction of fish from the waters of the Pacific Ocean; and deny that the hazards of the accidental injuries could not be validly covered by state law; deny that said vessel was moored [9] or anchored for the purpose of making certain repairs other than being fitted for use in a non-maritime enterprise.

ARTICLE IX.

These answering respondents admit the allegations contained in Article IX.

ARTICLE X.

In answer to Article X these answering respondents deny generally and specifically each and every allegation contained therein and every part and portion thereof.

ARTICLE XI.

These answering respondents admit the allegations contained in Article XI.

ARTICLE XII.

In answer to Article XII these answering re-

spondents deny that all and singular the premises are true and within the admiralty and maritime jurisdiction of the United States and of this Honorable Court.

Wherefore these answering respondents pray that this Honorable Court, after due consideration thereof, decree that the finding by the said Deputy Commissioner that said claimant's service at the time of his alleged injury was not maritime in character and that the claim does not come within the provisions of the Longshoremen's and Harbor Workers' Compensation Act, be affirmed and that the libelant take nothing by this action.

SYRIL S. TIPTON

Attorney for Respondents Hillcone Steamship Company, a corporation, Santa Cruz Oil Company, a corporation, and Associated Indemnity Corporation, a corporation.

[Verified]

[Endorsed]: Filed Mar. 30, 1942. [10]

[Title of District Court and Cause.]

ANSWER OF RESPONDENT WARREN A. PILLSBURY, DEPUTY COMMISSIONER, UNITED STATES EMPLOYEES' COMPENSATION COMMISSION TO LIBEL IN PERSONAM.

Comes now the respondent Warren A. Pillsbury, Deputy Commissioner of the United States Em-

ployees' Compensation Commission in and for the 13th District, by his attorney William Fleet Palmer, United States Attorney for the Southern District of California, and Howard V. Calverley, Assistant United States Attorney for said District and answers the libel filed herein as follows:

I.

Admits the allegations contained in Article I.

II.

Answering Article II, respondent admits the allegations of said paragraph, excepting that he denies that the respondent Hillcone Steamship Company was the owner of the Steamship "Prentiss" and alleges that said Steamship "Prentiss" was laid up at the dock of the [11] Santa Cruz Oil Company permanently.

III.

Answering Article III respondent admits the allegations of said Article, excepting that he denies that libelant was an able-bodied man during the month of February, 1937, and denies further that the libelant was in the employ of the Hillcone Steamship Company.

IV.

Admits the material allegations contained in Article IV.

V.

Admits the allegations contained in Article V, excepting that the respondent denies that the libelant's descent of said ladder and slipping thereon caused a

forcible wrenching of libelant's back and spine, causing libelant continued disability ever since said day to and including the filing of the libel.

VI.

Denies the allegations contained in Article VI.

VII.

Admits the allegations contained in Article VII.

VIII.

Denies the allegations contained in Article VIII, excepting that respondent admits that he is the Deputy Commissioner of the United States Employees' Compensation Commission in and for the 13th District, and made no findings as to the amount of libelant's average earnings for one year immediately preceding the month of February, 1937.

IX.

Admits the allegations contained in Article IX.

X.

Denies the allegations contained in Article X.

XI.

Answering Article XI, respondent is prepared to file with [12] the Clerk of the Court at any time fixed by the Court a certified copy of all proceedings had before him, together with all exhibits, transcripts of testimony and any and all letters and documents relevant to the matter herein contained and as directed by the Court.

XII.

Denies the allegations contained in Article XII.

XIII.

Admits the allegations contained in Article XIII.

Wherefore, respondent prays that the libelant take nothing by his ilbel.

WM. FLEET PALMER

United States Attorney

HOWARD V. CALVERLEY

Assistant U. S. Attorney

Counsel for Respondent Warren A. Pillsbury, Deputy Commissioner of the United States Employees' Compensation Commission, in and for the 13th District.

[Endorsed]: Filed Mar. 31, 1942. [13]

At a stated time, to-wit: The February Term, A. D. 1942, of the District Court of the United States of America, within and for the Central Division of the Southern District of California, held at the Court Room thereof, in the City of Los Angeles on Tuesday the 14th day of April in the year of our Lord one thousand nine hundred and forty-two.

Present: The Honorable Harry A. Hollzer, District Judge.

[Title of Cause.]

No. 1790-H Adm.

This cause coming on for setting for trial; R. P. Fontana, Esq., appearing as counsel for the plaintiff; Cyril S. Tipton, Esq., appearing as counsel for the Hillcone Steamship Company; James L. Crawford, Assistant U. S. Attorney, appearing as counsel for Warren A. Pillsbury, etc.;

Counsel state they may be able to present case on stipulation of facts and the law applicable thereto.

It is ordered that the cause be, and it hereby is, continued to May 4, 1942, for setting. [14]

At a stated term, to-wit: The February Term, A. D. 1942, of the District Court of the United States of America, within and for the Central Division of the Southern District of California, held at the Court Room thereof, in the City of Los Angeles on Monday the 4th day of May in the year of our Lord one thousand nine hundred and forty-two.

Present: The Honorable Harry A. Hollzer District Judge.

[Title of Cause.]

No. 1790-H Adm.

This cause coming on for setting; Cyril S. Tipton, Esq., appearing as counsel for Hillcone Steamship Company; Wm. Worthington, Assistant U. S. Attorney, appearing as counsel for Warren A. Pillsbury, etc.:

Counsel state that the cause may be submitted on evidence before the Court. It is ordered that the cause be heard on the record as now certified by the Commissioner and that briefs be filed as follows: Libelant's opening brief by May 14, 1942, Respondents' answering briefs by May 25, 1942, and Libelant's closing brief by May 30, 1942.

It is ordered that the cause be placed on the calendar of June 9, 1942, at 10 A. M. for argument and submission. [15]

CERTIFICATE OF WARREN H. PILLSBURY,
DEPUTY COMMISSIONER, UNITED
STATES EMPLOYEES' COMPENSATION
[16]

United States Employees' Compensation
Commission

13th Compensation District

In the matter of the claim for compensation under
the Longshoremen's and Harbor Workers Com-
pensation Act.

ALBERT V. STEFFEN,

Claimant,

vs.

HILLCONE STEAMSHIP COMPANY,

Employer.

ASSOCIATED INDEMNITY CORPORATION,

Insurance Carrier.

Case No. 2739-1

Claim No. 1545

CERTIFICATION.

This is to certify that I am the duly appointed, qualified and acting Deputy Commissioner of the United States Employees' Compensation Commission under the Longshoremen's and Harbor Workers' Compensation Act, for the Thirteenth Compensation District, comprising the State of California and other portions of the United States;

That there has recently been pending before me as said Deputy Commissioner, a claim for compensation under said Act of Albert V. Steffen against Hillcone Steamship Company, employer, and Asso-

ciated Indemnity Corporation, insurance carrier, my file No. 2739-1;

That the attached are originals or true and correct copies of pleadings, transcript of testimony, and exhibits in said file, as listed below, being a copy of the entire file therein so far as relevant to a review of the above proceeding:

1. Copy of Claim.
2. Copy of Answer.
3. Original Transcript of Testimony of February 5, 1941.
4. Original Transcript of Testimony of March 18, 1941.
5. Original Transcript of Testimony of April 17, 1941.
6. Copy of Compensation Order-Rejection of Claim of August 22, 1941.

Given under my hand at San Francisco, California, this -- day of March, 1942.

WARREN H. PILLSBURY

Deputy Commissioner

13th Compensation District

[17]

Case No. 2739-1

Insurance Carrier's No. 5

UNITED STATES EMPLOYEES'
COMPENSATION COMMISSION

Office of Deputy Commissioner

Administering Longshoremen's and Harbor Workers' Compensation Act

Employee's Claim for Compensation
(To be filed with the Deputy Commissioner in accordance with sections 13 and 19 of the law)

Injured Person

1. Name of employee—Albert V. Steffen.
Employee's check No.—
2. Address: Street and No.—U. S. Marine Hospital. City or town—San Francisco.
3. Sex—Male. Age—46. Married, single, widowed—Single.
4. Do you speak English?—Yes. Nationality—American.
5. State regular occupation—Watchman.
6. What were you doing when injured?—Leaving ship to answer phone.
7. (a) Wages or average earnings per day,—\$5.00. (Include overtime, board, rent, and other allowances.) (b) Per week, \$---. (c) Were you employed elsewhere during week in which you were injured?—No. (d) If so, state where and when—.
8. Were you paid full wages for day of accident?—Yes.

Employer

9. Employer—Hillcone Steamship Co.
10. Office address: Street and No.—311 California St., City or town—San Francisco.
11. Nature of business—Oil Transportation.

The Injury

12. Place where injury occurred—Craig Ship

Yard, Long Beach (Give place, and name of vessel)

13. Name of foreman—Fred H. Cordes, agent.

14. Date of accident or first illness, the—8th day of Aug. 1938, at 11 o'clock A. M.

15. How did accident happen or how was occupational disease caused?—Ladder on side of ship let go, causing me to fall. Bumping right knee. Falling about 6 ft. landing on railing injuring my back.

Nature and Extent of Injury

16. State fully nature of injury or occupational disease: After injury to 4th lumbar and right knee I have had constant pain, arthritis seems to have set in since accident.

17. On what date did you stop work because of injury? Aug. 8th, 1938.

18. Have you returned to work? (Yes or No.) No. If "yes," on what date?—

19. Does injury keep you from work? (Yes or No.) Yes.

20. Have you done any work in period of disability? No. Confined to hospital.

21. Have you received any wages since injury? Yes. If so, from and to what date? 8-31 9-15, 9-30-1938 While in hospital.

22. Has injury resulted in amputation? No. If so, describe same—

23. Did you request your employer to provide medical attendance? Yes. Has he done so? Yes.

24. Attending physician: Name—U. S. Public Health, San Pedro. Address—San Pedro, Cal.
25. Hospital: Name—U. S. Marine Hospital. Address—14th & Lake St., S. F.

Notice

26. Have you given your employer notice of injury? (Yes or No.) Yes. When? 8/8/38.
27. If such notice was given, to whom? Fred H. Cordes, (Agent).
28. Was it given orally or in writing? Orally.

I hereby present my claim to the Deputy Commissioner for compensation for disability resulting from an injury arising out of and in the course of my employment and not occasioned solely by intoxication, or by my willful intention, and in support of it I make the foregoing statement of facts.

Signed by ALBERT V. STEFFEN,

Claimant.

Mail Address,

U. S. Marine Hospital, City.

Dated Jan. 20, 1941.

[Filed Jan. 25, 1941 R.] [18]

United States Employees' Compensation
Commission

Office of Deputy Commissioner

Administering Longshoremen's and Harbor Workers'
Compensation Act.

Case No. 2739-1

Insurance Carrier's No. 5

Answer of Employer or Insurance Carrier
To Employee's Claim for Compensation

ALBERT V. STEFFEN,

Claimant,

vs.

HILLCONE STEAMSHIP CO.,

Employer

ASSOCIATED INDEMNITY CORP.,

Insurance Carrier.

The employer or insurance carrier above named
for answer to the claim respectfully shows:

1. It is denied that applicant sustained an injury on or about the date set forth in the application.

2. It is denied that both the employer and employee were subject to the Longshoremen's and Harbor Workers' Compensation Act at the time of the alleged injury.

3. It is denied that the relationship of employer and employee existed at the time of the injury.

4. It is denied that at the time of the alleged injury the employee was performing service growing

out of and incidental to his employment.

5. It is denied that notice of injury was given employer as specified in application.

6. It is denied that applicant was permanently disabled to the extent stated in application.

7. It is denied that applicant was temporarily disabled for the period stated in application.

8. It is denied that the rate of wages as set forth in application is correct.

9. It is alleged that this claim is barred by reason of the provisions of Sections 12 and 13 of the Longshoremen's and Harbor Workers' Compensation Act.

Signed R. O. PURVIS

Attorney for Employer
and Insurance Carrier.

[Filed Feb. 5, 1941 R.]

Note.—The employer or insurance carrier should answer the claim within ten days from the date that a copy of it is served upon him. The original answer should be mailed to the deputy commissioner at the above address and a copy thereof served upon the claimant either personally or by mailing to the address in the claim. [19]

United States Employees' Compensation Commission Before Warren H. Pillsbury, Deputy Commissioner, 13th Compensation District.

Claim No. 1545

Case No. 2739-1

ALBERT V. STEFFEN,

Claimant,

vs.

HILLCONE STEAMSHIP COMPANY and
SANTA CRUZ OIL COMPANY,

Employers,

ASSOCIATED INDEMNITY CORPORATION,
Insurance Carrier.

TRANSCRIPT OF TESTIMONY AT HEARING

Pursuant to notice, this matter was heard before Warren H. Pillsbury, Deputy Commissioner, United States Employees' Compensation Commission, at the United States Marine Hospital, at San Francisco, California, on February 5, 1941, at 10 A. M.

Appearances:

Claimant present and represented by Emmett Burns, Attorney.

Defendants represented by Roy O. Purvis, Attorney.

Mildred McColgan, Reporter. [21]

Mr. Pillsbury: Hearing on claim for compensation filed January 25, 1941. An answer has been filed.

This injury was not reported to me by any one and the first paper coming to my record concerning it was the claim of January 20, 1941, filed January 25, 1941.

Mr. Burns, what are you contending?

Mr. Burns: I claim that this case comes within the Longshoremen's Act, that he was employed by the Hillcone Steamship Company, that he was injured as he states here, sometime prior to August 8, 1938, and there was notice given to Mr. Cordes, his employer; that his employer took him to the hospital, and later up here; and they have acknowledged that they have told this man repeatedly, after having paid him several payments while in the hospital, they told him that he would be taken care of and get a lump sum, and it is finally gotten to a point where they will not answer his letters or communicate with him. First they came here and told him everything would be all right, everything would be taken care of, and I contend that the man is entitled to his compensation from the date of injury up to the present time, and whatever admittance papers were made out for the man were made out by them, whatever classification they put him under when they put him in the Marine Hospital, Mr. Cordes was present and he handled it.

Mr. Pillsbury: Who is Mr. Cordes?

Mr. Burns: The agent of the Hillcone Steam-

ship Company in [22] charge of the Los Angeles office, and is their employee, and we will develop the number of times he came here to see the patient, and after the first two payments that he received while here, which were for wages, was cut off and was told whenever he was ready to come out he would be given his wages and they would take care of him.

Mr. Purvis: I contend that the entire statement of facts given by Mr. Burns is false. He was never injured in the course of the employment, and any sums of money received from the employer were for wages for work performed and that no payments of money of any kind were made subsequent to that; at no time was the employer given any notice of claim of any injury, and further that he has been under treatment for a number of years for multiple arthritis and that the present condition can be proved to be a diseased process and not as a result of an injury.

THE FOLLOWING FACTS ARE AGREED TO
BY THE PARTIES:

1. That on and about the date mentioned in the claim, August 8, 1938, the Associated Indemnity Company, defendant herein, was the insurance carrier under the Longshoremen's and Harbor Workers' Compensation Act for defendant Hillcone Steamship Company and for the Santa Cruz Oil Company.

Mr. Pillsbury: As Mr. Purvis states that there

is a possibility that the employer, if any, might be the Santa Cruz Oil Company. [23]

It Is Stipulated that the Santa Cruz Oil Company may be joined as a party defendant in this proceeding, and it is hereby joined as such party defendant.

Mr. Purvis waives service of process and enters appearance for the Santa Cruz Oil Company and consents that the hearing proceed today, waiving ten days notice to them.

2. It is further agreed that no claim is made of intoxication or self-inflicted injury contributing to the alleged injury.

3. That medical treatment has been furnished to defendant by the United States Marine Hospital Service without expense to claimant or defendants.

4. That no compensation has been paid.

Mr. Pillsbury to Mr. Purvis: In that connection, according to the statement that some payments were made by the employer, do you wish to claim any credit for such payments if it is shown that they were made?

Mr. Purvis: I cannot consider that any such payments were made.

Mr. Pillsbury: If any payments were made under a theory of maintenance benefits to a seaman or otherwise, you do not ask for any credit for them?

Mr. Purvis: No, sir.

The issues are:

1. Who was the employer at the time of the alleged injury. [24]

2. Whether claimant was injured as claimed.
3. Whether such injury occurred in the course of his employment with either Hillcone Steamship Company or Santa Cruz Oil Company.
4. Whether such injury occurred in the course of and arose out of employment.
5. Whether the claim is barred by failure to give notice of injury in the manner prescribed by the Longshoremen's and Harbor Workers' Compensation Act.
6. Average earnings at the time of the alleged injury.
7. Extent of disability due to alleged injury.
8. Whether claimant's employment and the location of the alleged injury are such as to bring the claim within the Longshoremen's and Harbor Workers' Compensation Act.

An answer has been filed.

Mr. Purvis: I want to make an issue of the fact that the employee gave no notice to the employer and that therefore the claim is barred.

Mr. Burns: We contend on the other hand that notice was given to the employer and that he comes within Section 35.

Mr. Pillsbury: Mr. Purvis, you are relying on both sections 12 and 13 then, your answer sets up the allegation that the claim is barred by both sections, so you are now defending on the ground that notice was not given within thirty days and claim not filed within one year from injury? [25]

Mr. Purvis: That is correct, yes.

Mr. Pillsbury: The record may show both issues.

ALBERT V. STEFFEN,

claimant, being first duly sworn, testified as follows:

Mr. Pillsbury: Q. Your name is Albert V. Steffen? A. Yes.

Q. Your present address is United States Marine Hospital, San Francisco? A. Yes.

Q. You are claiming that you are ill by reason of some injury that you have sustained?

A. Yes.

Q. Now about when was this injury, Mr. Steffen?

A. Mr. Pillsbury, I swear it was in February, or about the time of that rain spell in 1937.

Q. The claim states it was about August 8, 1938?

A. Well, I made a mistake, because that was the time that Mr. Cordes let me have his car to go to San Pedro.

Q. How do you fix the date of the injury?

A. The only thing I can say is, just before that rain.

Q. What do you mean by that rain?

A. It was just two or three days before that terrible rain and Mr. Cordes came down to pick me up.

Q. What do you mean by that terrible rain? [26]

A. Well, it was a big wash out in Long Beach and washed out the bridge.

Q. You are speaking now of the flood of the Los Angeles River which caused rather heavy loss of life in Los Angeles County, including the washing out of the bridge at Long Beach? A. Yes.

(Testimony of Albert V. Steffen.)

Q. It would not be difficult to fix the date of that.

Mr. Pillsbury to Mr. Purvis: Now, Mr. Purvis, if the date of the alleged injury should be about February, 1937 instead of August 1938, would you stipulate still as to insurance coverage?

Mr. Purvis: No. I would not say that, because it commenced April 1, 1938, but it may be a renewal, but I don't know.

At this point the Deputy Commissioner raises the question of policy coverage in view of the dates covered by the previous stipulation, and after inquiry at his office, Mr. Purvis stipulates on further investigation, that the Associated Indemnity Company was the insurance carrier of the two alleged employers mentioned on or about February 1, 1937 and continuous to August 8, 1938 and all of the stipulations heretofore noted are included, with reference to the new date arrived at by claimant.

I am also under the impression that the February to which claimant alleges was the date of injury, occurred in 1938 [27] rather than 1937, but this can be checked from current information.

Mr. Pillsbury to Claimant: Q. Now at the time of this alleged injury, who were you working for?

A. My boss?

Q. Who was your employer?

A. Fred Cordes, he was the agent for the Hillcone Steamship Company.

Q. Do you know anything about a Santa Cruz Oil Company? A. Yes.

(Testimony of Albert V. Steffen.)

Q. Do you know whether you were on the payroll of the Hillcone Steamship Company or the Santa Cruz Oil Company?

A. I could have been on either one.

Q. What was your job at the time of this alleged injury?

A. I was a watchman, taking care of the S. S. "Prentiss".

Q. How long had you had that job?

A. I began work in 1931 and I was laid off during the strike.

Q. 1934 strike or 1936 strike? A. No

Q. First or second strike?

A. That was in 1934, and then I returned to work in 1935 or 1936, something like that, and I worked on through until August, whatever it was, I forget now. I was called over to the telephone, and they said that Mr. Cordes wanted me to [28] come over to be ready to make a trip to Los Angeles, and coming down off the ship, the ladder was on the bow.

Q. You are speaking now about how you got hurt? A. Isn't that what you want?

Q. Before you come to that, what kind of a job did you have? What did you do for these companies, or this company, from 1932 until the strike?

A. I was taking care of the S. S. "Prentiss" when she was tied up.

Q. As a watchman? A. Yes.

Q. Through those four years?

(Testimony of Albert V. Steffen.)

A. All the time.

Q. After the strike did you go back to work again in the same job? A. Yes.

Q. And were you working on the same job at the time of this accident? A. Yes.

Q. What did you do on this job?

A. I was to stay aboard, during 1936 I think it was, they were preparing the ship for a supply ship for the "American Fisher". They had engaged the "Birdie Hanlon" and was going to put this ship in condition to supply her, so they brought this ship down there to the "Birdie Hanlon", and there was a [29] tarpaulin that was missing and it demanded a man staying aboard at night, and there was no preparation on the ship at all, so we did the best we could in putting some mattresses in there to make a bed in the captain's quarters, and then it leaked so bad that I couldn't stay there any more and I told Mr. Cordes that something has to be done, and I noticed that with the dampness there that below deck had to be fixed, so he appropriated the fund to take care of that deck.

Q. When was that? A. About 1936.

Q. Did you continue on as watchman then on the "Prentiss"?

A. I have never been anything for the company but as a watchman.

Q. Now at the time of this accident, which you say was either February 1937 or 1938, what were your duties?

(Testimony of Albert V. Steffen.)

A. Just to go aboard, and I did a lot of painting in the day time and at night I had to stay aboard, and of course whenever Mr. Cordes wanted me to drive for him, I did.

Q. Drove his auto? A. His car, yes.

Q. Now was there any crew on the S. S. "Pren-tiss" at the time of your injury? A. No.

Q. How long had it been since there had been a crew on board at the time of your injury? [30]

A. They had been preparing that ship off and on for the last five years.

Q. Had the ship done any navigating during that five year period? A. No, sir.

Q. Where was it tied up?

A. At the Craig Shipyard in Long Beach.

Q. Why?

A. They were preparing it for a supply ship for the "American Fisher" and the "American Miraflores".

Q. What preparation had been going on?

A. Just removed a boiler and put some new booms on the side and moved her over to a dolphin over in the dry dock, and I can't remember the date, but anyway it was right after that that they had spent about eight thousand dollars and they were going to tie her up for a while, but my job was the same.

Q. Did it go into navigation after the injury?

A. No, I took care of it.

Q. Has it ever gone into navigation since your injury?

(Testimony of Albert V. Steffen.)

A. I don't know, I have been here for years.

Q. When did you last see the ship?

A. When I left it in August, whatever day it was.

Q. August, 1938? A. Yes.

Q. And do you know what has happened with reference to [31] the ship since then?

A. I know that they moved the ship.

Q. You say it was undergoing repairs and structural changes in the Craig Shipyard at the time of your accident? A. Yes.

Q. You were the only person working on board?

A. For a time there was Captain Corliss, First Mate, and Chief Speiler, and they stayed there for a while during the slack season, and later on they were transferred to the various ships.

Q. Now tell me how you got hurt?

A. Well, they called over to me, and I was coming off the ship and the ladder was from the bow to a sort of pontoon that was connected with the dry dock and the forward line was on the dry dock, and she was off on the dolphin here and the ropes of the ladder on one side, and in coming down, well, I couldn't swear to that, I don't know how far it was, —it was eight or ten feet, and the ladder let go and it hit my knee and I swung to one side and the next thing I knew my back was swung over to one side and I landed on my back, and I laid there for a little while, I don't know how long.

Q. Was the "Prentiss" afloat on navigable waters at that time?

(Testimony of Albert V. Steffen.)

A. It was right there in the dry dock.

Q. Was it in the dry dock? [32]

A. No.

Q. Was it afloat on the water? A. Yes.

Q. What were you going down at the time?

A. To answer a call from Mr. Cordes.

Q. What were you coming down?

A. A ladder.

Q. What kind of a ladder?

A. A shipyard ladder.

Q. Where was the ladder at the time?

A. Tied off the bow of the ship.

Q. From the ship to where?

A. To this pontoon.

Q. That was afloat in the dry dock?

A. Yes.

Q. And you were coming down that ladder when something broke?

A. The lashing let go, due to a broken line, it let go.

Q. Did you fall off the ladder?

A. Yes, on to the pontoon.

Q. How far did you fall?

A. To be honest, I would say about eight or ten feet.

Q. Now what was done about you as soon as you fell?

A. Well, I immediately went over to the yard, and Mr. Cordes was waiting for me, and I said, "I don't think I [33] can make this trip, I just had a terrible spill," and he said, "Hell, you will be all

(Testimony of Albert V. Steffen.)

right", so I got in and I drove but it pained me, and we got as far as Lancaster, and that is the reason I bring out the flood conditions, because it started to rain for a couple of days, so I turned the car around and I said, "We can't get through," and as I did, it got me, and it locked on me.

Q. What locked on you?

A. My back, and I said, "It's got me" and I told him I fell off the ship getting down here, and he said, "You will be all right", and then we went down to the Jonathan Club.

Q. Where is that?

A. Figueroa Street, Los Angeles, and we went in there and he immediately went down to see me, and he told a hold of me and worked on my back, and he said, "You got a bad back", and I went back up to the room, and we had a few drinks and we stayed around and we didn't go back for three days, and on the second day, we spent that in Mr. Cordes' pent house, and then it was very noticeable that I had to have a doctor, but we thought we would get by anyway, and the next morning we went down to the doctor and he taped me up.

Q. What doctor? A. Now you got me.

Q. Did Mr. Cordes send you?

A. No, I went by myself. [34]

Q. And you can't remember his name?

A. No, then later on, it was two days later—and every morning, the second morning at the Jonathan Club, they had to come in and help me to get in the

(Testimony of Albert V. Steffen.)

steam room, and after the steam they rubbed a liniment on my back to relieve me a little, and then we returned to Long Beach and I went aboard the ship for a few days, and then I went to a chiropractor and I went to an osteopath, and I went to Dr. Carroll, all kinds of doctors.

Q. Did Mr. Cordes or either Company tell you any doctor to go to at any time?

A. No, they never did, and then several months passed and I was getting so I could not stay on the ship any more due to dampness, and I was all stiffened up and my back ached all the time, and so I moved over into the Craig Shipyard in a shack there and I took care of the ship all I could, I would go over and wash down, they had an air hose and water hose, and I would go over and climb the ladder, and I told him I couldn't do it any more, and I said, "There is something go to be done", and I said, "My back is killing me", and he said "You better go around to San Pedro and see the Public Health there and they will take care of you, and I said, "I haven't got the money", and he said, "Never mind the money, they will take care of you", and they wanted to send me in an ambulance immediately to San Francisco. [35]

Mr. Burns: Q. Who was that who sent you there?

A. Fred Cordes, and they wanted to send me to San Francisco to the United States Marine Hospital.

(Testimony of Albert V. Steffen.)

Mr. Pillsbury: Q. Who wanted to?

A. That doctor, there, I think his name is Martin, the head of the Health Department in San Pedro, so he said I would have to go right away, and he wanted me to take an ambulance, and I became frightened, and then I saw my friend Captain Meany, and he said, "You don't have to take an ambulance", and he said, "You have to get him to San Francisco right away, that man has a bad back", so Captain Meany had a friend, and they drove me up, and I became very nervous, and I was up here two months and they kept paying me.

Q. In the Marine Hospital, San Francisco?

A. Yes, and they had me here two months, and my checks came right along, and then Fred came up to see me.

Q. That is Fred Cordes?

A. Yes, as a matter of fact, he was the only one who ever came to see me, and he said, "You will be all right, we will take care of you," and I said, "That is fine, Fred, I always enjoyed working for you, and I was kind of sick for a while there", and then Fred used to come up right along, and a ten spot and a five, always gave me money, and then I asked him one time, I said, "What do you have open for me?" and he said, "I have Jack Burns taking your place now and he is watching, [36] and we moved the ship", and he said, "When you get out we will take care of you", and then sometime later on Fred got married. I wrote to him congratu-

(Testimony of Albert V. Steffen.)

lations, because we were great friends since 1931, and I helped him in a lot of ways, and we carried on a correspondence right along, and I never worried until I wrote after he was married and asked him what about some compensation, and he never answered me, and I didn't know who to see, and I finally got a hold of a friend up here and he said he would take it up with you.

Q. With the Employees' Compensation Commission?

A. Mr. Burns took it up.

Q. You got in touch with Mr. Burns and Mr. Burns filed your claim? A. Yes.

Q. Have you been in the Marine Hospital continuously since you first came up here?

A. I was out for about four months over in Oakland with my sister, I didn't have to climb any stairs and it was all right to go there for a while.

Q. At the time of the accident, when you fell off the ladder, were you on duty at that time?

A. Sure I was on duty all the time because I was the only watchman.

Q. This was during your hours of work?

A. Sure, it was daylight too. [37]

Q. What were your wages at the time of this injury?

A. \$125.00, a little over, about \$63.00 every two weeks, I think I have a stub here (presents stub).

Q. That included your quarters on the boat?

A. Yes, I fed myself.

(Testimony of Albert V. Steffen.)

Q. You were not given any money separately for board?

A. No.

Q. So you got \$63.00 each two weeks?

A. Sometimes \$65.00 it varies with the tax.

Q. How much a month?

A. About \$125.00 (shows a form, being apparently the memorandum portion of a check bearing No. 4635, Statement of Account in full settlement of which payee has accepted the Santa Cruz Oil Corporation check. Salary, July 16th-31st, \$62.50, and the same is received in evidence as Exhibit "A".)

Q. Do you know what year that was?

A. It is 1931.

Q. It says 16-31 of July.

Mr. Burns: That is it.

Mr. Pillsbury: At this point it is agreed that in view of the necessity for further hearing at San Pedro and the probability that further testimony will be taken of claimant and other witnesses at the Marine Hospital, the hearing will now be suspended and when it is resumed here, both sides will resume the examination of claimant along with such other [38] evidence as may be ready, the matter to be set for hearing as soon as possible after my return from my Hawaiian trip on which I am leaving tomorrow, notices to be sent to the parties.

Mr. Purvis: Could we have a physical examination of Mr. Steffen by our doctor?

Mr. Burns: Certainly, you are entitled to have that.

It may be stipulated that I may add to the evidence as exhibits, such card certificates of insurance of the two employers mentioned herein, as I may have in my office, covering periods so far indicated by claimant's testimony.

I will notify the parties by letter of the material thus added to the record.

I hereby certify that the foregoing is a correct transcript of the testimony and proceedings taken in the above matter on February 5, 1941, at 10 A. M.

MILDRED McCOLGAN,

Reporter. [39]

COPY OF EXHIBIT "A"

Statement Of Account In full settlement of which
Payee has Accepted the Santa Cruz Oil Corporation check. No. 4635

Detach before Banking

Salary July 16-31	62.50	
Less: State UI Tax	.62	61.88

COPY OF INSURANCE CARDS

Employer Santa Cruz Oil Corporation

Address 311 California St. S.F. Calif.

Policy No. EP-15970 Effective 12/1/37 Expires
12/1/38

Report is made of this issue of approved form of policy and endorsement under Longshoremen's and Harbor Workers' Compensation Act.

Date 4/11/38

Cancellation 3/31/38

Associated Indemnity Corp.

(signature)

This card to be sent to the Deputy Commissioner of the United States Employees' Compensation Commission in the compensation district indicated by the Employers' address.

Form 228 2M 8-37 x

(Received April 13, 1938-Dist. 13

Employer Santa Cruz Oil Corporation

Address 311 California St. S.F. Calif.

Policy No. EP 15970 Effective 12-1-37 Expires
12-1-38

Report is made of this issue of approved form of policy and endorsement under Longshoremen's and Harbor Workers' Compensation Act.

Date 12-1-37

Cancellation 5/5/38

Effective date

Associated Indemnity Corp.

(signature)

Underwriter

Date notice received by Deputy 4/5/38

Replaced by E.P.18686 see let.4/5/38

Form 228 1 M 8-36 x filed under "H" [40]

July 19, 1937

Employer Santa Cruz Oil Corporation

Address Dollar Bldg. San Francisco, Calif.

Pol.No. W 71974 Beginning Date 6/21/37 Ending

Date 6/21/38

Report is made of this issue of approved form of policy and endorsement under Longshoremen's and Harbor Workers' Compensation Act.

St. Paul-Mercury Indemnity Co.
of St. Paul

By (signature)

Received July 15, 1937 Dist. 13

April 12, 1938

Employer Santa Cruz Oil Corporation

Address 311 California St. S.F. Calif.

Policy No. #EP-18686 Effective 4/1/38 Expires
4/1/39

Report is made of this issue of approved form of policy and endorsement under Longshoremen's and Harbor Workers' Compensation Act.

Associated Indemnity Corporation

By (Signature)

Date 4/8/38

Form 228

(Received 4/12/38 Dist. 13)

Employer Santa Cruz Oil Corporation

Address Dollar Bldg. S. F. Calif.

Policy No. W 72922 Beginning Date 6/21/38 End-
ing Date 6/21/39

/Report is made of this issue of approved form of policy and endorsement under Longshoremen's and Harbor Workers' Compensation Act.

St. Paul-Mercury Indemnity Co.
of St. Paul

By (signature)

Received 6/4/38 Dist. 13 [41]

Employer Hillcone Steamship Co.

Address 311 California St. S. F. Calif.

Policy No. EP-15970 Effective 12/1/37 Expires
12/1/38

Report is made of this issue of approved form of
policy and endorsement under Longshoremen's and
Harbor Workers' Compensation Act.

Associated Indemnity Corporation
(signature)

Date 4/11/38

Cancellation 3/31/38

Date Notice Received by Deputy

This card to be sent to the Deputy Commissioner
of the United States Employees' Compensation
Commission in the compensation district indicated
by the Employer's address.

Form 228 (Received 4/13/38 Dist. 13)
Cancelled

Employer Hillcone Steamship Company

Dec. 7, 1937

Address 311 California Street, S. F. Calif.

Policy No. EP 15970 Effective 12/1/37 Expires
12/1/38 (1st con let 4/11/38)

Report is made of this issue of approved form of
policy and endorsement under Longshoremen's and
Harbor Workers' Compensation Act.

Associated Indemnity Corp.

By (signature)

Underwriter

Date 12/1/37

Cancellation 5/5/38

Effective Date

4/5/38 Date Notice received by Deputy

Rep. by EP 18686

Form 228 (Received 12/2/37)

Employer Hillcone Steamship Co. April 12, 1938

Address 311 California St. S. F.

Policy No. EP-18686 Effective 4/1/38 Expires
4/1/39

Report is made of this issue of approved form of
policy and endorsement under Longshoremen's and
Harbor Workers' Compensation Act.

Associated Indemnity Corporation

By (signature)

Date 4/8/38

Form 228 M

Employer Hillcone Steamship Co. Dec. 14, 1936

Address 311 California St. S. F. Calif.

Policy No. 01-101117 Dates of beginning and ex-
piration 12/1/36-12/1/37. Report is made of this
issue of approved form of policy and endorsement
under Longshoremen's and Harbor Workers'
Compensation Act.

Maryland Casualty Company

Insurance Company

By (signed) Sam L. Webster

Comp. 2022 Printed in U.S.A.

(Received 12/14/36 Dist. 13) [42]

[Exhibit A follows here, a copy of which ap-
pears on page 83 of this printed record]. [43]

Copy forwarded to Washington.

Received Feb. 10, 1941. District No. 13.

[Filed Feb. 10, 1941.] [44]

[Title of Commission and Cause.]

TRANSCRIPT OF TESTIMONY AT HEARING
MARCH 18, 1941.

Pursuant to notice, this matter was heard before Warren H. Pillsbury, Deputy Commissioner, United States Employees' Compensation Commission, at Room 323, New Post Office Building, San Pedro, California, on the 18th day of March, 1941, at 2:00 P. M.

Appearances:

Claimant not present nor represented.

Defendants represented by Mr. S. S. Tipton,
Attorney at Law, 975 Subway Terminal
Bldg. of the legal staff of the Insurance
Carrier. [46]

The Deputy Commissioner: Mr. Tipton, have you any further information as to whether the correct name of the employer is Hillcone Steamship Company or Santa Cruz Oil Company?

Mr. Tipton: I think Mr. Cordes can establish he was employed by the Santa Cruz Oil Company.

The Deputy Commissioner: I believe it is established that the Associated Indemnity Corporation is the carrier?

Mr. Tipton: I believe that is true.

The Deputy Commissioner: At claimant's request I have been through the files of the United States Public Health Service at San Pedro with the Doctor in charge. He has loaned me his files which I will now read into the record.

The first is a record of some ear trouble, the date of the first treatment being around April 17, 1936. The form states that Albert V. Steffen, aged 38, merchant seaman, was received on a Master's Certificate showing a service as an A.B. from January 15, 1936 to March 20, 1936, on the vessel "Edwin B. DeGolia". The history was "States is hard of hearing, has wax in ears." Diagnosis was "Accumulation of wax." Four visits are listed from March 20, 1936 to April 13, 1936 and there is a letter attached to the file from Dr. Harry D. Earle, dated April 17, 1936 stating the original complaint was [47] headache, irritable throat, constant drainage from the back of the throat and obstruction of nose.

The other file shows but one visit of July 27th, 1938. "Albert V. Steffen, aged 40, Merchant Seaman. Authority for admission was Master's Certificate showing service on January 3, 1938 to July 27, 1938 as a Steward aboard SS "Brandywine." The history on the card reads as follows: "Has been suffering from rheumatism for the past four months, which affects right knee, right lumbar spine and right shoulder. The metatarsal of right foot is swollen and tender, the right knee is considerably tender and motion is limited. Diagnosis Arthritis chronic." The record of treatment contains but one entry as follows:

Date 7-27-38. Give In-patient card to U. S. Marine Hospital, San Francisco." The card does not contain any claim of injury or accident.

Now I will take Mr. Cordes' testimony.

FRED H. CORDES,

being duly sworn by the Deputy Commissioner, testified as follows:

Direct Examination

By the Deputy Commissioner:

Q. What is your full name please?

A. Fred H. Cordes. [48]

Q. Your address please?

A. 3051½ Avalon Boulevard, Wilmington.

Q. Your occupation?

A. District Manager of Hillcone Steamship Company, also agent for Santa Cruz Oil Company and I handle two or three sales lines.

Q. Do you know Albert V. Steffen?

A. Yes.

Q. Was he employed by the Santa Cruz Oil Company about August 1938, or August 1937?

A. I think in August 1938 he was in the United States Marine Hospital here. He was employed with us previous to that. I don't know the dates offhand.

Q. He was working on what boat?

A. The "Prentice".

Q. What was his position?

A. Watchman.

Q. Do you know of his sustaining a fall on that boat some four or six months before he became ill?

A. No, I don't.

Q. Did he ever tell you about the accident?

A. No.

Q. Now as to the date, Mr. Cordes, there is some

(Testimony of Fred H. Cordes.)

uncertainty in the claim. Mr. Steffen states he fell from the ladder on the 8th of August, 1938. In his testimony he [49] states he thought the accident was in February, 1937, but he also states that it was about the time of the heavy rain which caused a big washout in Long Beach and washed out the bridge. He also reported to the Marine Hospital at San Pedro and was sent to the Marine Hospital at San Francisco on July 27, 1938. He speaks of this fall being some time shortly before a trip he made with you in driving a car for you in which he drove you as far as Lancaster which was just before the start of this rain and then told you his back was so bad he could not go on and you and he went into the Jonathan Club at Los Angeles. Do those statements, Mr. Cordes, refresh your recollection to the extent that you can fix any of the items in this case?

A. I remember one time we were going to go to San Francisco. We were going to leave on the morning of the day this storm broke out. If I remember correctly it started to rain about eight o'clock at night. That day I had a vessel in loading at one of the terminals here and I didn't want to leave until she had cleared. She was late in getting away and I decided to stay in Los Angeles until she had cleared. At the time the rain had appeared and we decided to stay in Los Angeles, which we did. The storm broke that night and it rained all that day and the next day.

Q. Do you recall the date of that storm?

(Testimony of Fred H. Cordes.)

A. No, I don't remember. I think it was March but [50] what year I don't remember. But as far as driving me to Lancaster and everything else, that is entirely erroneous. We did not get any further than Los Angeles. The weather conditions were so bad we did not try to go through, and came back to Long Beach.

Q. You didn't go to San Francisco?

A. Oh no.

Q. Do you know how far you got?

A. Los Angeles.

Q. The city limits are very far.

A. We stopped with a friend at San Marino Street.

Q. It is your testimony is it that Mr. Steffen never told you he complained to you that he had a fall?

A. No. If he had injured himself in any way and came to me and told me I would have seen to it that he would have gone to a doctor.

Q. Do you recall during this storm that he recalled having trouble with his back?

A. He had trouble with his back a long time before that.

Q. What do you recall as to his back trouble?

A. It was months before he went to San Francisco that he complained of his back trouble, and he had pains in the legs with something like sciatica.

Q. What do you remember specifically about his back? [51]

(Testimony of Fred H. Cordes.)

A. I don't remember exactly. He told me he had been sick with arthritis or whatever name they give it. That he had been in a hospital in the East. That he was all crippled up, that his arms were crossed like that (Indicating arms on each shoulder).

Q. Do you remember what hospital?

A. No, I don't remember that he told me of the hospital.

Q. Do you know when he complained before he left?

A. I would say three or four months before he left.

Q. What did he tell you?

A. He complained of awful pains across his back. He didn't know where it came from or what to do about it. I told him he better look up a good doctor and let him diagnose his case. He didn't go to a doctor for awhile and then went to a couple of quacks I would call them.

Q. Do you remember the name of the doctor?

A. The only name he gave me was Dr. O'Connell in the Press Building, Long Beach.

Q. I see in his letter reference to Southern Pacific records. Do you know anything in connection with Southern Pacific Railroad in regard to his case?

A. No, sir.

Q. What did he do on the "Prentice"?

A. I would say nothing at all. [52]

(Testimony of Fred H. Cordes.)

Q. What was his job?

A. Just to stand by on the boat and see that nobody went aboard to steal things. When he was able he would sweep up sometimes and when he got well he didn't do anything at all.

Q. What living quarters did he have?

A. He had a bunk in there with a mattress.

Q. Did he have heat on the boat?

A. I believe he did have an electric heater in there but he didn't stay on the boat much.

Q. Where did he live?

A. I believe it was 916 Atlantic Avenue, Long Beach. Then he moved down to Ten Hundred and something Ocean Boulevard. He lived in a shack at Craig Shipyard.

Q. Do you know how long he lived in a shack at Craig Shipyard?

A. I believe a couple of months. The only reason he lived there was that he was trying to save money and was so sick he couldn't get along very well.

Q. Did he give up the room at the "Prentice" at the time he took this room at Craig Shipyard?

A. Yes.

Q. How long did he sleep on the "Prentice"?

A. I couldn't tell you. I believe most of the time he went ashore to sleep at night. [53]

Q. What has happened to the "Prentice" since?

A. She was sold to the Craig Shipbuilding Corporation at Long Beach and later on scrapped—

(Testimony of Fred H. Cordes.)

that is to my knowledge. I think the hull was converted to a fishing barge afterwards.

Q. How long before did the "Prentice" go to sea?

A. I couldn't say. She never went to sea when with us.

Q. How long did your company own her?

A. About 2½ years.

Q. When did you give her up?

A. About a year and a half ago.

Q. What did your company purchase her for—for what purpose?

A. She was to be reconditioned and fixed up for a tender ship for the fishing reduction plants which were operating out of San Francisco off the Farallone Islands.

Q. You called on Mr. Steffen several times when he was in the hospital?

A. Yes.

The Deputy Commissioner (To Mr. Tipton): Mr. Tipton, any questions?

Mr. Tipton: Yes.

By Mr. Tipton:

Q. Do you remember Steffen's wage with you?
[54]

A. I think it was \$125.00 a month.

Q. At the time you saw Mr. Steffen at the time he left your work did you ever advise him at any time that you or your company would take care of him?
A. No.

Q. Was that ever discussed? A. No.

(Testimony of Fred H. Cordes.)

Q. What was the last time you saw Steffen, if you remember?

A. I believe it was nine or ten months ago.

Q. When did he first start working for you or when did you first have any contact or knowledge of Mr. Steffen—how many years ago?

A. When I first became acquainted with him?

Q. Yes.

A. About five or six years ago.

Q. After that first acquaintance and prior to this time he began to complain just before he went to San Francisco, had he any trouble with his back or legs?

A. He had trouble with his back and legs during all that time, off and on.

Q. It was the same condition as he claims now?

A. That is right.

Q. It would clear up and come back again?

A. Yes, that is right. [55]

Q. During the time the vessel was owned by you it was never in service? A. No.

The Deputy Commissioner: Have you any further evidence to offer, Mr. Tipton?

Mr. Tipton: I haven't any further evidence but I can get the report of Dr. O'Connell. He has no records but will give us his recollection of his treatment of the man in 1921, if the Commissioner agrees.

The Deputy Commissioner: The record may be added to the file.

(Testimony of Fred H. Cordes.)

Mr. Tipton: One more question.

Q. Where was that vessel tied up?

A. Craig shipyard.

Q. Was that at the drydock?

A. At the mooring dock.

The Deputy Commissioner: Hearing will be continued at a date to be set for hearing at the Marine Hospital, San Francisco.

I Hereby Certify that the foregoing is a true and correct transcript of the testimony and proceedings at the hearing held at Room 323, New Post Office Building, San Pedro, California, on the 18th day of March, 1941.

SARA L. LANGLEY,
Reporter.

[Endorsed]: Filed April 4, 1941. [56]

[Title of Commission and Cause.]

TRANSCRIPT OF TESTIMONY AT HEARING
APRIL 17, 1941

Pursuant to notice, this matter was heard before Warren H. Pillsbury, Deputy Commissioner, United States Employees' Compensation Commission, at the United States Marine Hospital, at San Francisco, California, on Thursday, the 17th day of April, 1941, at 2:30 P. M.

Appearances:

Claimant present in person.

Defendants represented by Walter Jacobson, Attorney, appearing for Mr. Purvis.

Mildred McColgan, Reporter.

Witness	Page
Albert Steffen	2-14
Dr. Robt. A. Bilafer	5
	[58]

ALBERT V. STEFFEN,

claimant, being previously sworn, testified as follows:

Mr. Pillsbury: Now, Mr. Steffen, you have read the transcript of the testimony taken at San Pedro on March 18th, have you?

A. Yes, I just had a chance to read it for a few minutes while the man was here.

Q. Do you desire to make any further statement with reference to the testimony given by Mr. Cordes?

A. Well, in regard to docking the ship, the ship was tied up, I say it was tied up to the Craig shipyard dry dock, the bow line was on the dry dock. He has it there it was on a mooring, that could have been over at Cataline somewheres.

Q. Now, he states that you never told him about any accident to you?

(Testimony of Albert V. Steffen.)

A. Well, I can't say anything only that I must have told him because he knew it all the time or he would not have sent me to the Public Health in San Pedro, otherwise I could not get into the Public Health in San Pedro and get here.

Q. Did you tell him that you had an accident on the ship? A. Yes, I did.

Q. Now on the records of the Public Health Service appears the entry that you called July 27, 1938 on a master certificate showing service as a steward on the S. S. "Brandywine". At that time you gave the history of suffering from rheuma- [59] tism for the past four months which affects the right knee, right lumbar spine and right shoulder and also the right foot, and doesn't contain any statement that you had made of any accident.

A. I know I told the doctor there at the time he examined me, I just sat alongside the table and he looked at me and I told him what had happened to my back, I told Dr. Graham, a gray haired doctor, I told him it was all because of a fall off the ship, that is what I told him, I explained that I fell off the ladder.

Mr. Jacobson: Q. You testified that you must have told Mr. Cordes about this fall for the reason that that gained your entry into the Marine Hospital? A. I did tell him.

Q. Now isn't it a fact that your entry to the Public Health Service down there was arranged for by a Captain Kimberlinn of the S. S. "Brandy-

(Testimony of Albert V. Steffen.)

wine", do you deny that Captain Kimberlinn took you to the Service? A. He didn't.

Q. Didn't Captain Kimberlinn make arrangements to have you here at this hospital?

A. No, I stated that it was all done by Mr. Cordes.

Q. Who actually and physically went with you?

A. Mr. Cordes.

Q. Went with you? [60] A. Yes.

Q. Had you worked as a steward on the S.S. "Brandywine" just before that? A. No.

Q. When did this accident take place that you testified to?

A. I think it was in March or the latter part of February or March, 1938.

Q. 1938? You are fairly positive of the year, you thought it was 1937 and Mr. Pillsbury corrected you that perhaps it might have been 1938, now what is your recollection today on that?

A. Well, let's see, it was the time of the washing out of the bridge, of the big rain, and I think that was 1938.

Q. Following this supposed fall, what doctor did you go to first, what medical attention did you get?

A. The Public Health.

Q. Following this accident that you had, who was the first doctor that you saw?

A. Dr. Graham, Public Health.

Q. Some time in July, 1938?

A. No, that was before that.

(Testimony of Albert V. Steffen.)

Mr. Pillsbury: I will suspend the examination of claimant at this time so we can release the doctor.

[61]

DR. ROBERT A. BILAFER,

witness, being first duly sworn, testified as follows:

Mr. Pillsbury: Q. Your full name, please?

A. Robert A. Bilafer.

Q. You are a physician and surgeon and a member of the staff of the United States Marine Hospital?

A. Yes.

Q. Do you have the file here of Mr. Steffen?

A. Yes.

Q. Under what circumstances was he admitted to the hospital, doctor?

A. He was admitted to the hospital on August 5, 1948 with a card "D" from San Pedro, stating that he had three years of service up to August 4, 1938 on the "Prentiss".

Q. And was any history given on that card?

A. The history which was taken on August 5th—

Q. Did any history come up with him from San Pedro?

A. I think there is a card "D" but I will have to go fishing for it. (Reads) The card "D" from San Pedro states, under remarks, "Merchant seaman, sent up with arthritis chronic" and that is the extent of the notes. (Presents card dated July

(Testimony of Dr. Robert A. Bilafer.)

28, 1938, entitled, "Hospital admission card, U. S. P. H. S. District 5, station San Pedro, California, United States Marine Hospital San Francisco will please admit A. V. Stiffen, age 40, sex male, color white, class, merchant seaman. Remarks, [62] D 138 arthritis chronic, (signed) R. E. Bodet, Surgeon, Medical Officer in charge."

Q. Now, doctor, what history was obtained from Mr. Steffen on his admission here?

A. The chief complaint was arthritis, and he stated, seven months ago he fell from his ship, striking his back on a pontoon. He went on with his work and later while driving from Los Angeles, his back began hurting him. He later suffered from what he described rheumatic pains. Later his right knee and right foot became swollen and his left foot became involved. However, the pain practically vanished from the left foot. He had suffered previously when the weather was damp and cold. He also has nauseating feeling which he feels came from a discharge in his nose and throat. That is all.

Q. What was the diagnosis, doctor?

A. The diagnosis made on August 5, 1938 was arthritis, chronic, hypertrophic, right knee, ankle and spine; cardiac disease, atrial miocardial block, complete.

Q. When was your first personal acquaintance with the case, doctor?

A. On April 27, 1939, and since that time.

(Testimony of Dr. Robert A. Bilafer.)

Q. Since that time what has your diagnosis been?

A. Osteoarthritis chronic of the lumbar spine, hammer toes of the 2d, 3d, 4th and 5th toes bilateral callosity, sole of left foot, papillomata, sole of left foot, arthritis, [63] chronic, both feet, synovitis, chronic, right knee, sinusitis, chronic, cardiac disease, miocarditis, chronic, stricture, urethral, posterior, slight.

Q. Assume, doctor, that about February, 1938, he fell from a ladder on the side of a ship, a distance of about six feet, falling on his back, and has complained of pain in his back since that time; assume further, that he was not in any known physical abnormal condition prior to that time, that is, that he didn't know at that time that he had been suffering from any previous illness, what is your opinion, doctor, as to whether he has suffered any disability since the time he entered the hospital, as a result of such an injury?

A. Will you repeat that, please?

(Question reread.)

Q. In other words, doctor, has he been suffering or is he now suffering from any condition which would be the result of such a fall?

A. He could well have had an aggravation of a pre-existing arthritis of the spine, right knee and ankle, and I feel it has given him considerable trouble since the date of the injury because of such aggravation.

Q. How long, doctor, does the effect of such an

(Testimony of Dr. Robert A. Bilafer.)

injury continue to be present as the contributing cause to the continuance of this disability?

A. That all depends entirely on the degree of the injury, the degree of the osteoarthritis, the general condition of the [64] patient.

Q. Let me ask you this way, has he reached a stage at any time at which he would be suffering from the pre-existing arthritis uninfluenced by any further contributing influence of the fall?

A. That is a very difficult question to answer.

Q. These arthritic back cases are about the most difficult type of cases that I have.

A. I feel that the back pain that he complains of now could well have been caused by the aggravation.

Q. You think if he had not had this accident of an equivalent accident he would have remained able to do his full work during the whole period after February, 1938, or would the arthritic condition have approximately brought to him about the same extent of disability in the course of time without the accident?

A. That may or may not be true, one could not answer that question definitely, as we all know, arthritis progresses, and here is a man at the age of forty-one, it might be that his arthritis would be giving him pain had he not had the accident.

Q. Were x-rays taken? A. Yes.

Q. Were there traumatic conditions shown by the x-rays? A. No, sir.

(Testimony of Dr. Robert A. Bilafer.)

Q. How extensive is the arthritis in the first x-rays? [65]

A. The roentgenologist stated on August 9, 1938, that he observed evidence of a bilateral arthritic change of both right and left saeral synchondrosis, with evidence of certain degree of chronic infectious arthritis, hypertrophic type of osteoarthritis deformans of the lumbar spine including the lumbo-dorsal junction, lumbo-sacral junction.

Q. Do later x-rays show any change or any extension of the condition?

A. On May 24, 1940, the report states the bodies of the twelfth dorsal, first, second, third and fifth lumbar vertebra are observed on the negative, which shows a definite arthritic change, chronic infectious arthritis, hypertrophic type of osteoarthritis deformans of the lumbar spine including the lumbo-dorsal junction, lumbo-sacral junction.

Q. Have you access to the x-rays, doctor?

A. Yes, on August 21st, in comparison——

Q. In what year?

A. 1940,—in comparison with the present, with the previous negative observed a report on May 24th of the present negative shows a marked or essential change in the amount of the extent of the existing chronic infectious arthritis, that is the only comparison that we have had. I will get the x-rays for you.

Q. Where is the most of his disability now, doctor, in the back or in the other joints? [66]

(Testimony of Dr. Robert A. Bilafer.)

A. His chief disability now is both his back and his feet.

Q. Doctor, taking this film of August 7, 1938, how much indication of arthritis is there in this film of 27431, would you say it is severe or slight?

A. I would say it is slight.

Q. And this film of August 7, 1938, does that show an extensive condition, or slight?

A. Slight.

Q. And this film of the foot of August 15, 1938, does that show arthritis?

A. To a slight degree.

Q. Now this film of August 20, 1940, how does that appear?

A. There doesn't appear to be any essential change in the arthritic changes as evidenced by the x-ray findings.

Q. To what extent is Mr. Steffen disabled from working as a stevedore or doing heavy physical work at this time?

A. He is totally disabled for heavy physical work at this time.

Q. Because of what condition?

A. Because of osteoarthritis of his back, knee and feet.

Q. And is that condition active and painful?

A. It is painful, yes.

Q. Any muscle spasm of the back?

A. There is some muscle spasm, I have not examined Mr. Steffen's back for some time. [67]

Mr. Jacobson: Q. Doctor, these numerous

(Testimony of Dr. Robert A. Bilafer.)

symptoms or conditions that Mr. Steffen's has, could they not be explained on an infectious basis almost consistently, right down the line?

A. What is that again?

Q. You have enumerated the arthritis, the condition of the toes, synovitis of the right knee, sinus infection, cardiac condition, are these not practically all explained on the infectious origin?

A. No, sir.

Q. What symptoms or condition that he has are there that are purely of traumatic origin?

A. The only condition present in the list of diagnoses given that could definitely be traumatic, is the synovitis of the right knee.

Q. That is the only one that could definitely be traumatic? A. Yes.

Q. All of those are infectious? A. No, sir.

Q. Which are not?

A. Hammer toes and callosity and papillomata are not infectious in origin but come from an abnormal weight bearing of the feet, which may have been due to many causes.

A. It is constitutional, would you say, or just a physical abnormality? [68]

A. Depends upon what you mean by constitutional and what you mean by physical abnormality.

Mr. Pillsbury: Q. Doctor, to clear the record, these back sprains or arthritic back cases usually come to me on the theory of an aggravation or an exacerbation of a pre-existing osteoarthritis by trauma, is that the case here, in your opinion?

(Testimony of Dr. Robert A. Bilafer.)

A. In my opinion I feel that his present condition could have been due to an aggravation of a pre-existing condition.

Q. Then the accident, assuming it to have occurred, did not cause the arthritis?

A. No, sir.

Q. It was there before but was aggravated and made painful by the accident.

A. Yes, it might have.

Q. And the arthritis has not itself, increased any since the accident? A. No, sir.

Q. Now the condition of hammer toes and the papillomata, those were not effected by the injury, assuming there to have been a fall?

A. That depends entirely upon the condition of his feet prior to the alleged injury.

Q. Doctor, how many of the items in the diagnosis that you have referred to might be explained, in your opinion on [69] the theory of aggravation of pre-existing arthritis by accident, and how many of the items are wholly independent of any injury and not effected by it?

A. Osteoarthritis chronic in the lumbo-sacral spine, synovitis chronic of the right knee are the conditions that probably were aggravated on the date of the alleged injury.

Q. And the remainder of your diagnosis may be attributed, may they, as not bearing any relation to the supposed injury? A. Yes.

Q. So we are down to two conditions that may

(Testimony of Dr. Robert A. Bilafer.)

be attributed to the injury in whole or in part?

A. Yes.

Mr. Jacobson: Q. Could Mr. Steffen have had those two conditions in their present form independent of the alleged fall of 1938?

A. He could have had the two conditions in their present form independent of the alleged fall.

Q. Therefore the accident could or could not have aggravated it?

A. Yes, that is what I have been trying to say all afternoon.

Mr. Pillsbury: Mr. Steffen, do you want to ask the doctor any questions?

Mr. Steffen: No.

Mr. Pillsbury to Mr. Jacobson: Any further questions of [70] Mr. Steffen?

Mr. Jacobson: Yes, I have.

ALBERT V. STEFFEN,

claimant, recalled, testified as follows:

Mr. Jacobson: Q. Mr. Steffen, I think the last question I asked you was, what was the first medical attention that you sought following this fall, was it Dr. Graham?

A. No.

Q. Who was it?

A. I tried to tell at the last hearing, the first

(Testimony of Albert V. Steffen.)

doctor was in the Los Angeles, I think, he taped up my back.

Q. Do you know his name?

A. No, I don't know, I tried to remember it here at the last hearing.

Q. About when was that?

A. The latter part of February.

Q. Was it an M. D. or an osteopath?

A. Yes, an M. D.

Q. How did you happen to go to him?

A. Mr. Cordes and I were in Los Angeles and we were going to drive to San Francisco, and we went to Los Angeles and the back bothered me and we stopped at the Jonathan Club and then I had severe pain and could hardly get around, and we went to the steam room and Eddie, the chief rubber there, told me, he was a friend of Mr. Cordes, "You got a bad back there, [71] you better go to a doctor", and I said, "I will get by all right, I will go to the Public Health when we get back. Mr. Cordes is going to send me over, and three nights I laid around, stayed at his pent house and while we were at the pent house I was so sick my back was throbbing so that I couldn't straighten it up and I went to some doctor, the lady that owned the pent house told me about, and I went to him and he said, "All I can do is that I can tape it", that is the first doctor.

Q. Who was the next doctor?

(Testimony of Albert V. Steffen.)

A. Dr. Sittle, he is in Long Beach in the First National Bank Building on the second floor.

Q. Spell the name, please?

A. I think S-e-t-t-l-e. I have his card upstairs and can make positive of it, he was a chiropractor.

Q. You went to him how long after this fall?

A. That was when we returned to Long Beach, now let me see, we returned to Long Beach,—I think that rain was the 2d, 3d, 4th, and about the 5th would be right that we returned to Long Beach, and that week end I think Mr. Cordes took me back down to the ship and I stayed aboard that night and the next night, and I couldn't tell you the date.

Q. Approximately? A. It was in March.

Q. Did you tell the doctor how you hurt yourself?

A. No, I told him I had a bad back and he said, I can't [72] adjust it'', but he did adjust the fore part.

Q. You didn't tell him about the fall?

A. Sure, sure.

Q. Did you see any one after that?

A. I have \$25.00 worth of receipts from Dr. Godfrey, something like that.

Q. Where is he? A. In Long Beach.

Q. What kind of a doctor is he?

A. An M. D. I have his receipts for you, if you wish.

Q. Now along about when did you go to him?

(Testimony of Albert V. Steffen.)

A. I had about ten treatments from Dr. Settle and he said, "It is absolutely impossible for me to do anything because I can't give you the correct adjustment", so I went to this other doctor, Dr. Godfrey, and he gave me a corset with a cork in the back here, and he also treated me electrically, some electric treatments.

Q. That was about when?

A. March I think, I think that was in April, March or April, and then I went over to Pedro later on.

Q. How long were you under treatment by Dr. Godfrey?

A. Darned if I know, I couldn't tell you that, I have got about \$25.00 worth of receipts.

Q. For visits? A. Yes. [73]

Q. At least five visits? A. Yes.

Q. You paid for them yourself? A. Yes.

Q. After Dr. Godfrey what kind of treatment did you have?

A. Dr. Earl, I think I went to the Public Health then.

Q. How long after April?

A. I couldn't tell you now, about around in May, I don't know.

Q. You think some time in May?

A. It was right about that.

Q. Dr. Earl?

A. Dr. Earl treated me, yes, I was sent to him by this doctor in the Public Health.

(Testimony of Albert V. Steffen.)

Q. For what condition?

A. I had a bad sinus, we were using paint on the ship before that.

Q. Aren't you confused in your dates, the Public Health Service record contains an entry dated San Pedro, that about April 17, 1936, you called at the Public Health Service and were sent to H. D. Earl and were given four treatments by him, the original complaint was headache, irritable throat, constant drainage from the back of the throat.

A. Yes, I am in error there.

Q. That was two years before? [74]

A. Yes.

Q. Then this doctor didn't send you there?

A. No, the next time I went to the Public Health Service I was sent up here.

Q. So there was no visit to the Public Health between the time of your fall and the time you were sent up here?

A. No, Mr. Cordes sent me over to the Public Health Service.

Q. Did you go to any osteopath?

A. Mr. Cordes said that brother John had lumbago, and they were over at the yard and they sent for me to come over, and they said that this osteopath had done marvelous work, and I told him it was only the bad fall that I had, so they were going to send me over to some other doctor down in town.

Q. Did you go?

A. No, but they were going to send me over.

(Testimony of Albert V. Steffen.)

Q. In your testimony, page fifteen, you stated that you went to a chiropractor and went to an osteopath and then you went to Dr. Carroll, was there a Dr. Carroll who treated you?

A. The only Dr. Carroll that I knew, I saw him in,—yes I did.

Q. Who is Dr. Carroll?

A. He is an osteopath, a chiropractor and M. D. if you can believe that.

Q. Where is his office? [75]

A. Kress Building.

Q. Long Beach? A. Yes.

Q. When did you go to him?

A. I couldn't tell you.

Q. Did you go to him after this fall?

A. Yes and for this back.

Q. Was that between the time of your fall and the time you entered the Marine Hospital?

A. Yes, but I can't give you the exact date.

Q. How many times?

A. Just the one time because he, himself, said that I should go to a hospital, that my back was too bad for adjustment, he would not even treat me, I think he did give me a sacroiliac adjustment on the table.

Q. You are sure it was just the one time?

A. Sure.

Q. Isn't it a fact that you had been seeing Dr. Carroll since 1931?

A. No, I should say not, the only time I remember——

(Testimony of Albert V. Steffen.)

Q. How did you remember the building he was in? A. Because I was up there.

Q. You were only there the one time?

A. Sure, absolutely.

Report of Dr. C. C. Carroll of Long Beach, California, [76] dated March 17, 1941, received in evidence as Exhibit "A" of this date, copy being furnished claimant.

Mr. Pillsbury: Q. How long have you known Dr. Carroll, Mr. Steffen?

A. I have known him for about fifteen years.

Q. He states he has treated you perhaps twenty times, going back to possibly 1931, is that correct?

A. That is absolutely incorrect, your Honor, Dr. Carroll cannot make statements like that, he really cannot because I didn't pay him for the one treatment that he gave me.

Mr. Jacobson: Q. Mr. Steffen, how long have you been troubled with the back disability?

A. I didn't have any back disability, I mean, I have never had any back aches I might say until I had this fall, because I used to play baseball, I was a pitcher in the yard there, on the team.

Q. Did you ever seek medical treatment for your back prior to 1938? A. No.

Q. Never was hospitalized for it? A. No.

Q. You were involved in a rather serious automobile accident several years ago, prior to this accident?

A. I had an automobile accident where I broke

(Testimony of Albert V. Steffen.)

my nose and got a black eye and lost some teeth. [77]

Q. But not your back? A. No.

Q. Never had any trouble with your back in Minnesota? A. No.

Q. How long have you been troubled with your knees or legs swelling up?

A. I haven't had any legs swelling up, no.

Q. Before or after this accident?

A. Never had swollen legs.

Q. Never sought any treatment for that?

A. For swollen legs, never.

Q. Now did you ever write to your employer or communicate with Mr. Cordes following this accident, concerning this fall? A. Yes.

Q. Did you ever receive any replies?

A. I had a letter, personal letters from Fred ever since I was in here and he has called on me here.

Q. In connection with your injury?

A. Certainly.

Q. Have you got the letters?

A. No. You asked me if I ever asked or talked to him about it, certainly I have, and he sent several letters, because we were good friends.

Q. You have known him several years?

A. Yes. [78]

Q. Going back how far?

A. I should say 1930, roughly, 1932.

Q. Did you ever receive any communication from any one else connected with the Hillcone

(Testimony of Albert V. Steffen.)

Steamship Company or the Santa Cruz Oil Company following your injury, in connection with your injury, discussing it in any way? A. No.

Q. When was the last time that you had heard from Mr. Cordes in discussing your injury with you?

A. Just before he got married, I don't know what date it is, but I have a letter telling me just when he got married, and he was going to come back and I met his wife outside here and she asked me, "How is your back?" and he told me not to worry about it, that he was going to take care of it.

Q. How long ago was that?

A. Last year—when did he get married now, let's see, I think he got married in October or November.

Q. Of last year, 1940? A. Yes, 1940.

Q. Now you entered this hospital about August, 1938, did you not, or thereabouts?

A. I don't know, I think that is all right.

Q. At any rate you reported to the Public Health Service in San Pedro about that time and you were referred directly from there to here? [79]

A. That is right.

Q. Have you received any wages or compensation or indemnity from that time to the present?

A. Yes, there was two checks, I think I have one here for August, I think I have one, I gave you the last time, it was for July, I think that is August (hands slip to Mr. Jacobson).

(Testimony of Albert V. Steffen.)

Q. For August 16th to 31st, no year on it, you say this is for 1938?

A. Yes, I had two and I think in my last hearing when I testified, I think you will find the other one was for July and one was August.

Q. Now, as a matter of fact, at the time you made entry at the Public Health Service at San Pedro and up here, you were destitute as far as finances was concerned, you needed funds?

A. This was my job, that is all.

Q. That was your last check? A. Yes.

Q. Have you received anything else from that time on?

A. No, nothing, but Mr. Cordes came up now and then and gave me a little money on the side.

Q. That was a personal gratuity?

A. I assumed that it was with the understanding that I would get out and be back on the job again.

Q. Now you worked for the Company until what time, when was the last date of your employment on the "Prentiss"? [80]

A. When I left, that is when I came up here.

Q. Then you actually did work as a watchman on that vessel until about the time of your departure for San Francisco?

A. That is right.

Q. Therefore that salary check that you showed us covered the extent of your employment there?

A. Well, it could be, but I was in here, I think

(Testimony of Albert V. Steffen.)

the latter part of July, isn't it, and this covers August.

Q. Now have you anything in writing that would show that Mr. Cordes represented that your claim would be taken care of by the Company or the insurance company? A. No.

Q. Have you anything in writing that would show that Mr. Cordes acknowledged that you had told him about the fall out there at work?

A. No.

Q. I think that is all, Mr. Pillsbury.

Mr. Pillsbury: Have you any further documentary evidence?

Mr. Jacobson: No, I understand Mr. Purvis requested to have Mr. Steffen examined by a doctor, and it would be quite satisfactory to us to appoint a doctor, at our expense, it would be satisfactory.

Mr. Pillsbury: I have already the report from the United States Marine Hospital of San Francisco through Dr. Bilafer's testimony as attending physician, he is a government doctor. [81] Do you wish to have me appoint some outside specialist?

Mr. Jacobson: We think the record is deficient in that respect and because we have nothing to contradict what has been offered.

Mr. Pillsbury: You spoke of an automobile accident in Minnesota, have you any record of that?

Mr. Jacobson: No, an automobile accident, not necessarily in Minnesota.

Q. Where was the automobile accident?

A. I had an automobile accident in Bakersfield.

(Testimony of Albert V. Steffen.)

Q. How long ago was that?

A. Darned if I know.

Q. Was that within your acquaintance with Mr. Cordes?

A. No.

Q. Did you ever tell him about it?

A. I think I told him about it.

Q. Did you ever discuss any ailments or conditions that you had with Mr. Cordes that you attributed to that accident?

A. No, I never had any aches from that accident.

Q. Have you ever been in Minnesota?

A. Well, let's see, what part?

Q. Any part of the State.

A. I was born and raised there.

Q. Did you ever seek any treatment there?

A. You are going way back in history now, I haven't been [82] home for twelve years now, it is more than that.

Mr. Pillsbury: We are only concerned with your back now, primarily.

A. I never had any trouble with my back before.

Mr. Pillsbury to Mr. Jacobson: Have you any communications from Mr. Steffen to Mr. Cordes, or Mr. Cordes to Mr. Steffen?

Mr. Jacobson: There is nothing here, no communications whatsoever, I think our file starts with a letter that somebody in the company received from Mr. Hallinan or Mr. Burns, and they communicated with Mr. Burns and he wrote back.

(Testimony of Albert V. Steffen.)

Mr. Pillsbury: I think I will avail myself of the privilege given by the Longshoremen's Act of making an investigation and enter the case personally. This is because of claimant being in San Francisco and unable to develop anything personally in Southern California, and I may call on two or three of the doctors mentioned, and at the shipyard. Such information as I obtain will be written in the form of notes and added to the record, copy being sent to each side at the time.

Claimant states that he will write to a friend who will get his papers at a shack in the Craig shipyard and send them to him here. In that case, Mr. Steffen, you may write me a letter as soon as you get your papers, giving me any further information you find there, names of doctors, dates, and so on.

The hearing will remain open until I can look into the [83] matter personally at Long Beach on my next trip to Southern California. In the meantime each side will send me any further documentary evidence they obtain for filing, with a copy to the other side. If no request is received for further hearing or proceedings within five days after service to the parties of copy of such notes as I may develop and place in the file, I will assume that the matter is submitted for decision without further notice to the parties.

I hereby certify that the foregoing is a correct transcript of the testimony and proceedings taken in the above case at the hearing held on April 17, 1941, at 2 P. M.

MILDRED McCOLGAN

Reporter. [84]

EXHIBIT A

4/17/41

Long Beach, California

March 17, 1941

Mr. Warren H. Pillsbury
Deputy Commissioner
13th Compensation District

Dear Sir:

I will state I have known Albert Steffen for the past approximately ten years. During that time I have treated him possibly twenty times the first time dating back to possibly 1931.

He has never given me any history of being injured or of any accident being the cause of the condition for which I was treating him at any time.

The first few times I saw him he complained of aches and stiffness and soreness in his feet, which I diagnosed as arthritis.

He did not improve so well and in time one leg began to swell and both knees. From the first time I saw him he complained of pains in his back.

I did not know what was causing his trouble and told him it was an arthritic condition. He did not

say anything to me about his work causing his trouble.

It has at least been three years since I have seen him.

He stopped treatments with me without any consent on my part and I believe the manipulations were doing him some good towards the last.

I don't recall him giving me any history of his having this trouble for any period prior to my first seeing him approximately ten years ago.

His only trouble seemed to be in his feet, legs and back and he made no complaint of any trouble in any other part of his body.

I have kept no written record of Mr. Steffen's visits or treatments and this statement is to the best of my memory and I have read this report and it is true and correct.

Yours very truly,

C. C. CARROLL, D. O. [85]

Copy forwarded to Washington.

Received Apr. 19, 1941, District No. 13.

Filed April 19, 1941. [86]

[Title of Commission and Cause.]

COMPENSATION ORDER REJECTION
OF CLAIM

Case No. 2739-1

Claim No. 1545

Such investigation in respect to the above entitled claim having been made as is considered necessary and a hearing having been duly held in conformity with law, the Deputy Commissioner makes the following:

FINDINGS OF FACT

That during the month of February, 1937 the claimant above named was in the employ of the employer above named, Santa Cruz Oil Company, at Long Beach, in the State of California, in the 13th Compensation District, established under the provisions of the Longshoremen's and Harbor Workers' Compensation Act, and that the liability of the employer for compensation under said Act was insured by the Associated Indemnity Corporation;

That claimant contends that about said time he sustained injuries to his back by the slipping of a ladder extending from a pontoon to said ship, while he was leaving said ship in the course of his work;

That at said time claimant was employed as a watchman or caretaker on board the S. S. "Pren-tiss" and had been so employed for more than two years. That said vessel did not go to sea or engage in commerce or navigation at any [87] time during

said period. That there was no crew on board during said time. That said vessel had been purchased by the employer with the intention of reconditioning and remodeling her for service in connection with certain fish reduction plants but that the employer eventually sold said vessel without putting her into use in such or any capacity as a vessel. That at the time of said injury said vessel was indefinitely laid up. That claimant's employment as said watchman and caretaker was not maritime in character.

Upon the foregoing facts it is ordered by the Deputy Commissioner that the claim be and it is hereby Rejected for the following reasons:

That claimant's service at the time of his alleged injury was not maritime in character, and claimant does not come within the provisions of the Longshoremen's and Harbor Workers' Compensation Act.

Given under my hand at San Francisco, California this 22nd day of August, 1941.

WARREN H. PILLSBURY,

Deputy Commissioner

WHP:P

13th District

PROOF OF SERVICE

I hereby certify that a copy of the Compensation Order, Rejection of Claim, was sent by registered mail to the claimant, the employer, and the insurance company as follows:

Mr. Albert V. Steffen, c/o U. S. Marine Hospital, San Francisco, California;

Hillcone Steamship Co., 311 California Street,
San Francisco, California;

Associated Indemnity Corporation, 332 Pine St.,
San Francisco, California;

and by regular mail to:

Emmett Buris, Attorney, 369 Pine St., San
Francisco, California.

USECC

Mailed.....

Deputy Commissioner

Received Aug. 23, 1941, 11 a. m. Registered Mail.

[Endorsed]: Filed Mar. 31, 1942. [88]

At a stated term, to-wit: The February Term,
A. D. 1942, of the District Court of the United
States of America, within and for the Central
Division of the Southern District of California,
held at the Court Room thereof, in the City of Los
Angeles on Wednesday the 10th day of June in the
year of our Lord one thousand nine hundred and
forty-two.

Present: The Honorable Harry A. Hollzer, District
Judge.

No. 1790-H Adm.

ALBERT V. STEFFEN,

Libelant,

vs.

HILLCONE STEAMSHIP CO., a corp., et al.,
Respondents.

This cause coming on for argument and submission (to be heard on record); A. A. Goldstone, Esq., appearing as proctor for the libelant; Cyril S. Tipton, Esq., appearing as proctor for Hillcone Steamship Co., a Corp.; and H. V. Calverley, Assistant U. S. Attorney, appearing as proctor for Warren A. Pillsbury, etc.:

Attorney Goldstone argues in behalf of the libelant; the Court reads portions of various authorities; Attorney Goldstone makes a further statement; and Attorney Tipton makes a statement.

It is ordered that the cause stand submitted. [89]

At a stated term, to-wit: The February Term, A. D. 1942, of the District Court of the United States of America, within and for the Central Division of the Southern District of California, held at the Court Room thereof, in the City of Los Angeles on Wednesday the 19th day of August in the year of our Lord one thousand nine hundred and forty-two.

Present: The Honorable Harry A. Hollzer, District Judge.

[Title of Cause.]

This cause having heretofore been heard by the Court on evidence both oral and documentary, and counsel having argued the cause, and the Court being duly advised as to the facts and the law, now hands down its written memorandum of conclusions and orders that proctors for libelant submit a Decree in conformity therewith. [90]

[Title of District Court and Cause.]

MEMORANDUM OF CONCLUSIONS,
JUDGE HOLLZER, AUGUST 19, 1942

It appearing that at all times involved herein libelant was employed by respondent Santa Cruz Oil Company as a watchman on the S. S. Prentiss; and

It further appearing that said vessel had been purchased by said respondent about the spring of 1937 for the purpose of fitting the same out as a supply ship to other vessels in connection with fish reduction plants operating off the *Ferralone* Islands in the Pacific Ocean; and

It further appearing that throughout the entire period said vessel was owned by said respondent, the same was moored at Long Beach and was afloat in waters of the Pacific Ocean, that from time to time on various occasions during said period work was performed on said vessel for the purpose of fitting the same out as such supply ship, that at no

time during said period was said vessel navigated, nor was any crew on board the same; and

It further appearing that while said vessel was moored at Long Beach for the purpose of being refitted as aforementioned, to-wit in February, 1937, libelant sustained certain injuries while engaged in the performance of duties as such watchman, as he was proceeding from said vessel onto an adjoining pontoon; and [91]

It further appearing that at no time involved herein was said vessel permanently withdrawn from navigation, that said respondent continued to own and to retain the possession and control of said vessel until the fall of 1939, when the same was sold and thereafter scrapped, that up until said vessel was sold it was the intention of said respondent to refit the same as a supply ship as aforementioned and to return it to navigation, and that at no time prior to 1939 was said vessel withdrawn from registry;

The Court Concludes that at the time libelant sustained injuries as aforementioned his service or employment was maritime in character.

The Court Further Concludes that at the time of sustaining said injuries libelant was engaged in maritime employment upon navigable waters of the United States.

The Court Further Concludes that at the time of sustaining said injuries libelant was in the employ of respondent Santa Cruz Oil Company, and that recovery for such disability through Work-

men's Compensation proceedings may not validly be provided by state law.

The Court Further Concludes that libelant is entitled to relief under the Longshoremen's and Harbor Workers' Compensation Act.

See 33 U.S.C. sec. 901 et seq; *South Chicago Co. v. Bassett*, 309 U. S. 251; *Puget Sound N. Co. v. Marshall*, 31 F. Supp. 903; *Richards v. Monahan*, 17 F. Supp. 252; *Merchants & M. T. Co. v. Norton*, 32 Fed. (2) 513; *Union Oil Co. v. Pillsbury*, 63 Fed. (2) 925; *Crowell v. Benson*, 285 U. S. 22; *Seneca etc. Corp. v. McManigal*, 65 Fed. (2) 779; *Carumbo v. Cape etc. Co.*, 123 Fed. (2) 991.

[Endorsed]: Filed Aug. 19, 1942. [92]

[Title of District Court and Cause.]

OBJECTIONS TO FINDINGS OF FACT AND CONCLUSIONS OF LAW

To the Honorable Harry A. Hollzer, Judge of the United States District Court, Southern District of California, Central Division:

Comes Now Hillcone Steamship Company, a corporation, Santa Cruz Oil Company, a corporation, and Associated Indemnity Corporation, a corporation, and object to the Findings of Fact and Conclusions of Law submitted herein in the following respects and for the following reasons:

Said Respondents object to paragraph four of the Findings of Fact, lines 18 to 22, inclusive, on

Page 2, upon the ground that said finding is outside of the issues as submitted herein.

The finding of the United States Employees Compensation Commissioner was to the effect that said libelant was not engaged in a maritime occupation at the time of his alleged injury, and this is the sole issue that was presented by this petitioner, and the issue as to whether or not said applicant sustained an industrial injury is an issue which should properly be determined by the Commissioner after the taking of further evidence.

Wherefore these respondents respectfully submit that paragraph four of the Findings of Fact should be eliminated.

Dated: September 21, 1942.

Respectfully submitted,

SYRIL S. TIPTON

Attorney for Petitioning Respondents.

[Endorsed]: Filed Nov. 9, 1942. [93]

[Title of District Court and Cause.]

REPLY TO OBJECTIONS TO FINDINGS OF
FACT AND CONCLUSIONS OF LAW

To the Honorable Harry A. Hollzer, Judge of the
United States District Court, Southern District
of California, Central Division:

Comes now the libelant, Albert V. Steffen, and
replies to the objections of the respondents Hillcone

Steamship Company, a corporation, Santa Cruz Oil Company, a corporation, and Associated Indemnity Corporation, a corporation, to the Findings of Fact and Conclusions of Law, as follows:

1. The injury to the libelant in the manner set forth in libelant's opening brief has been both explicitly and implicitly admitted and acted upon by the objecting respondents, and it was upon the fact of such injury as stated that both libelant and the objecting respondents based their briefs and arguments. (Respondents' Brief, p. 1, lines 14, 15, and 16, to end of first sentence).

At the opening of the oral argument on June 10, 1942, the court took up the existence of the employer and employee relationship and the occurrence of the injury to libelant while libelant was acting within the scope and course of his employment, and [94] both counsel for the objecting respondents and for the libelant agreed with and assented to the statement of the court that at the time of injury to the libelant, the relation of employer and employee existed and that libelant was injured while acting within the scope and course of his employment.

The objecting respondents therefore have not questioned the Findings as to the existence of the employer and employee relationship (lines 3 to 5, inclusive, p. 2, Findings of Fact and Conclusions of Law) nor have they questioned that libelant was injured while acting within the scope and course of his employment as stated by the court, but they do

attempt to call into question whether or not libelant sustained "an industrial injury." (Objections to Findings of Fact and Conclusions of Law, p. 1, lines 26 to 28).

2. There being no dispute between the parties to this proceeding that (a) the libelant was injured by a fall from a ladder attached to the S. S. Prentiss as set forth in libelant's opening brief; (b) that at the time of his injury the libelant was employed as a watchman on the S. S. Prentiss by the respondents Hillcone Steamship Company and Santa Cruz Oil Company, or one of them; (c) that at the time of his injury the libelant was acting within the scope and course of his employment; (d) and that at the time of libelant's said injury the S. S. Prentiss was moored in the waters of the Pacific adjacent to Long Beach, California, it was stipulated and agreed by and between the objecting respondents and libelant, through their respective counsel, that the liability of the objecting respondents be determined upon the single disputed issue, that is, whether or not the service or employment of the libelant as a watchman on the Steamship Prentiss at the time of his injury was maritime in character

The character of the injury to libelant, that is, whether "industrial", meaning whether or not the injury was compensable [95] under the Longshoremen's and Harbor Workers' Compensation Act, was necessarily and actually embraced within the question of whether libelant's employment at the time of his injury was maritime in character.

Since both the question of the libelant's injury and the sustaining of the injury by the libelant and the manner of sustaining it were properly before the court and were not disputed, and since the objecting respondents agreed to submit the question of their liability under the Longshoremen's and Harbor Workers' Compensation Act for compensation to libelant upon the single issue of whether the employment of the libelant at the time of his injury was maritime in character, the objection to the Findings of Fact and Conclusions of Law made by the objecting respondents is not well taken and is not a proper or valid objection.

Wherefore, it is submitted that paragraph four of the Findings of Fact is a proper finding within the issues and before the court in this proceeding and should remain.

Dated: October 20, 1942.

Respectfully submitted,

WM. P. LORD and

FONTANA & GOLDSTONE

Attorneys for Libelant.

[Endorsed]: Filed Nov. 9, 1942. [96]

[Title of District Court and Cause.]

OBJECTIONS TO THE PROPOSED DECREE

To the Honorable Harry A. Hollzer, Judge of the
United States District Court, Southern Dis-
trict of California, Central Division:

Comes Now Hillcone Steamship Company, a corporation, Santa Cruz Oil Company, a corporation, and Associated Indemnity Corporation, a corporation, and object to the proposed Decree submitted herein in the following respects and for the following reasons:

That paragraph two of said Decree, being that portion of said Decree beginning at line 4, to and including line 10 on Page 2, should be amended to read as follows:

“That this cause be remanded to the Deputy Commissioner, 13th Compensation District, U. S. Employees Compensation Commission for the purpose of determining the rights of said libelant against the Respondents, and each of them, under the Longshoreman's and Harbor Workers' Compensation Act.”

Said paragraph should be so amended for the reason that the sole issues submitted in this proceedings was whether or not the libelant was at the time of the alleged injury engaged in a maritime employment, and whether or not the Deputy Commissioner of the U. S. Employees Compensation Commission had jurisdiction of said cause. [97]

Wherefore, your respondents respectfully submit that said Decree should be amended as above set out.

Respectfully Submitted,

SYRIL S. TIPTON

[Endorsed]: Filed Nov. 9, 1942. [98]

[Title of District Court and Cause.]

REPLY TO OBJECTIONS TO THE
PROPOSED DECREE

To the Honorable Harry A. Hollzer, Judge of the
United States District Court, Southern District of California, Central Division:

Comes now the libelant, Albert V. Steffen, and replies to the objections of the respondent, Hillcone Steamship Company, a corporation, Santa Cruz Oil Company, a corporation, and Associated Indemnity Corporation, a corporation, to the proposed decree, as follows:

The objecting respondents make no objection to that portion of the proposed decree on page 2, lines 2 and 3, that libelant is entitled to relief under the Longshoremen's and Harbor Workers' Compensation Act. The objecting respondents therefore admit that libelant is entitled to such relief and that the decree is proper in awarding relief by way of compensation.

The objecting respondents and the libelant, through their respective counsel, stipulated that the

liability of the objecting respondents be determined upon the single disputed issue of whether or not the service or employment of the libelant as a watchman on the S. S. Prentiss at the time of his injury was maritime in [99] character. If his employment was maritime in character, the libelant was entitled to and should have compensation under the Act. If his employment was not maritime in character at the time of his injury, he was not entitled to such compensation.

The only matter left for further determination in this proceeding is the actual amount of compensation due the libelant. The parties, through their respective counsel, having agreed to submit the case on briefs and the court having properly determined that libelant is entitled to compensation and all other matters and issues in the case except the exact amount of compensation to be paid to the libelant, it is proper for the court to provide in the decree that this cause be remanded to the Deputy Commissioner, 13th Compensation District, U. S. Employees Compensation Commission, for the sole purpose of fixing the amount of compensation due to libelant by reason of his injury.

The amendment to the decree suggested by the objecting respondents is for the purpose of attempting to again try and determine the rights of the libelant which have already been properly tried and determined in this proceeding. The objection to the decree is therefore not a valid one and the proposed amendment to the decree is neither proper nor valid.

Wherefore it is submitted that the Decree should not be amended but should remain unchanged.

Dated: October 20, 1942.

Respectfully submitted

WM. P. LORD and
FONTANA & GOLDSTONE
Attorneys for Libelant

[Endorsed]: Filed Nov. 9, 1942. [100]

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS
OF LAW

The above entitled action came on regularly to be heard on the 10th day of June, 1942, before the above entitled Court, the Honorable Harry A. Hollzer, Judge Presiding, without a jury, the libelant appearing by his attorneys, William P. Lord and Fontana & Goldstone, A. A. Goldstone of counsel, the respondents Hillcone Steamship Company, Santa Cruz Oil Company, and Associated Indemnity Corporation appearing by their attorney, Cyril S. Tipton, and the respondent Warren A. Pillsbury, Deputy Commissioner, 13th Compensation District, U. S. Employees Compensation Commission, appearing by William Fleet Palmer, United States Attorney, and Howard V. Calverley, Assistant United States Attorney, Howard A. Calverley of counsel; the parties hereto, through their

respective counsel, having stipulated that the liability of the respondents be determined on the issue of whether or not the service or employment of the libelant, at the time he admittedly was injured, was maritime in character, and the cause having been submitted on the record as certified by said Deputy Commissioner and upon the stipulations, oral argument and briefs of counsel, [101] and the court being fully advised in the premises, now makes its Findings of Fact and Conclusions of Law as follows:

FINDINGS OF FACT

I.

That at all times involved herein libelant was employed by respondent Santa Cruz Oil Company and was engaged in the performance of his duties as a watchman on the S. S. Prentiss.

II.

That said vessel had been purchased by said respondent about the spring of 1937 for the purpose of fitting the same out as a supply ship to other vessels in connection with fish reduction plants operating off the *Ferralone* Islands in the Pacific Ocean.

III.

That throughout the entire period that said vessel was owned by said respondent, the same was moored at Long Beach, California, and was afloat in waters of the Pacific Ocean; that from time to time on various occasions during said period work was per-

formed on said vessel for the purpose of fitting the same out as such supply ship; and that at no time during said period was said vessel navigated, nor was any crew on board the same.

IV.

That at no time involved herein was said vessel permanently withdrawn from navigation; that said respondent continued to own and to retain the possession and control of said vessel until the fall of 1939, when the same was sold and thereafter scrapped; that up until said vessel was sold it was the intention of said respondent to refit the [102] same as a supply ship, as afore-mentioned, and to return it to navigation, and that at no time prior to 1939 was said vessel withdrawn from registry.

CONCLUSIONS OF LAW

And as Conclusions of Law from the foregoing, the court concludes that at the time libelant sustained injuries as aforementioned, his service or employment was maritime in character; that at the time of sustaining said injuries libelant was engaged in maritime employment upon navigable waters of the United States; that at the time of sustaining said injuries libelant was in the employ of respondent Santa Cruz Oil Company, and engaged in the performance of the duties of such employment; that recovery for such disability through Workmen's Compensation proceedings may not validly be provided by state law; and that libelant

is entitled to relief under the Longshoremen's and Harbor Workers' Compensation Act.

Let judgment be entered accordingly.

Dated November 9, 1942.

H. A. HOLLZER

U. S. District Judge

[Endorsed]: Filed Nov. 9, 1942. [103]

In the United States District Court, Southern District of California, Central Division.

No. 1790-H

ALBERT V. STEFFEN,

Libelant

vs.

HILLCONE STEAMSHIP COMPANY, a corporation; SANTA CRUZ OIL COMPANY, a corporation, et al.

DECREE

The above entitled action came on regularly to be heard on the 10th day of June, 1942, before the above entitled Court, the Honorable Harry A. Hollzer, Judge Presiding, without a jury, the libelant appearing by his attorneys, William P. Lord and Fontana & Goldstone, A. A. Goldstone of counsel, the respondents Hillcone Steamship Company, Santa Cruz Oil Company, and Associated In-

demnity Corporation appearing by their attorney, Cyril S. Tipson and the respondent Warren A. Pillsbury, Deputy Commissioner, 13th Compensation District, U. S. Employees Compensation Commission, appearing by William Fleet Palmer, United States Attorney, and Howard V. Calverley, Assistant United States Attorney, Howard A. Calverley of counsel; the parties hereto, through their respective counsel, having stipulated that the liability of the respondents be determined on the issue of whether or not the service or employment of the libelant, at the time he admittedly was injured, was maritime in character, and the cause having been submitted on the record as certified by the Deputy Commissioner and upon the stipulations, oral arguments and briefs of counsel, [104] and the court being fully advised in the premises, and having made its Findings of Fact and Conclusions of Law,

It Is Hereby Ordered, Adjudged and Decreed As Follows:

That libelant is entitled to relief under the Longshoremen's and Harbor Workers' Compensation Act.

That this cause be remanded to the Deputy Commissioner, 13th Compensation District, U. S. Employees Compensation Commission for the sole purposes of fixing the compensation due to libelant, Albert V. Steffen, by respondents Santa Cruz Oil Company and Associated Indemnity Corporation, and each of them, and, if necessary to take additional testimony in relation to such compensation

in order to determine the amount thereof, and to fix the compensation due attorneys for libelant for services rendered in this proceeding.

It is further ordered that libelant recover from respondents Santa Cruz Oil Company and Associated Indemnity Corporation his costs herein expended, the same to be taxed by the clerk of this court.

Dated November 9, 1942.

H. A. HOLLZER

U. S. District Judge

Judgment entered Nov. 9, 1942. Docketed Nov. 11, 1942. M. B. Book 30, Page 412.

EDMUND L. SMITH,

Clerk,

By L. WAYNE THOMAS

Deputy

[Endorsed]: Filed Nov. 9, 1942. [105]

[Title of District Court and Cause.]

PETITION FOR APPEAL

To the Honorable Harry A. Hollzer, United States District Judge for the Southern District of California, Central Division:

Your petitioners, Hillcone Steamship Company, a corporation, Santa Cruz Oil Company, a corporation, and Associated Indemnity Corporation, a corporation, and each of them, respondents herein,

pray that they may be permitted to take an appeal from the Final Decree entered in the above entitled cause on November 10, 1942, in Minute Book 30 at Page 410, to the United States Circuit Court of Appeals for the Ninth Circuit, for the reasons specified in the Assignments of Error filed herewith, and that their said appeal be allowed and their bond for costs on appeal in the sum of Two Hundred Fifty Dollars (\$250.00), filed herewith, be approved.

Dated: January 18, 1943.

HILLCONE STEAMSHIP
COMPANY,
a corporation,
SANTA CRUZ OIL COMPANY,
a corporation,
ASSOCIATED INDEMNITY
CORPORATION,
a corporation,
Appellants
S. S. TIPTON
A. G. RITTER
Attorneys for Appellants [106]

ORDER ALLOWING APPEAL

Petition granted and appeal allowed. The amount of the cost bond on appeal is hereby fixed in the sum of Two Hundred Fifty Dollars (\$250.00).

Dated: January 18, 1943.

H. A. HOLLZER
United States District Judge

[Endorsed]: Filed Jan. 18, 1943. [107]

[Title of District Court and Cause.]

COSTS BOND ON APPEAL

Whereas, Hillcone Steamship Company, a corporation; Santa Cruz Oil Company, a corporation and Associated Indemnity Corporation, a corporation, Respondents herein, have appealed or are about to appeal from that certain final decree heretofore made and entered in the above entitled cause on November 10, 1942 in Minute Book 30, Page 410, and

Whereas, Pacific Indemnity Company, a corporation organized and existing under and by virtue of the laws of the State of California and authorized to do a general surety business in the State of California is held and firmly bound unto the Libellant herein and unto Whom it May Concern in the sum of Two Hundred Fifty & No/100 Dollars (\$250.00) for the payment of which well and truly to be made it does hereby bind itself, its successors and assigns firmly by these presents and agrees that in case of default or contumacy on the part of the said Appellants or of the undersigned, execution may issue against it, its goods, chattels and lands;

Now, Therefore, the condition of this obligation is such that if the above named Appellants shall prosecute said appeal with effect and pay all costs which may be awarded against them as such appellants, if the appeal is sustained, then this obliga-

tion shall be void, otherwise the same shall be and remain in full force and effect.

Dated at Los Angeles, California, this 15th day of January, 1943.

The Premium charged for this Bond is \$10.00 per annum.

PACIFIC INDEMNITY COM-
PANY,

By W. E. BENING,

Attorney-in-Fact.

Examined and recommended for approval as provided in Rule

S. S. TIPTON,

A. G. RITTER,

Attorney.

I hereby approve the foregoing bond dated the 18 day of January, 1943.

H. A. HOLLZER,

Judge.

State of California,

County of Los Angeles—ss.

On this 15th day of January in the year one thousand nine hundred and forty-three before me, Atala M. Carter, a Notary Public in and for said County and State, residing therein, duly commissioned and sworn, personally appeared W. C. Bening known to me to be the duly authorized Attorney-in-Fact of Pacific Indemnity Company, and the same person whose name is subscribed to the within instrument as the Attorney-in-Fact of said Company, and

the said W. C. Bening acknowledged to me that he subscribed the name of Pacific Indemnity Company, thereto as surety and his own name as Attorney-in-Fact.

In witness whereof, I have hereunto set my hand and affixed my official seal the day and year in this Certificate first above written.

(Seal) ATALA M. CARTER,
Notary Public in and for Los Angeles County, State
of California.

My commission Expires May 28, 1946. [108]

[Endorsed]: Filed Jan. 18, 1943.

[Title of District Court and Cause.]

DESIGNATION OF PARTS OF APOSTLES ON APPEAL AND PRAECIPE

Now come appellants, Hillcone Steamship Company, a corporation, Santa Cruz Oil Company, a corporation, and Associated Indemnity Corporation, a corporation, and each of them, and designate the following parts of apostles on appeal in said matter.

1. Libel in personam.
2. Answer of Hillcone Steamship Company, a corporation, Santa Cruz Oil Company, a corporation, and Associated Indemnity Corporation, a corporation, and each of them.
3. Answer of respondent, Warren A. Pillsbury, Deputy Commissioner, 13th Compensation District, U. S. Employees Compensation Commission.

4. Certified copy of record of Warren A. Pillsbury, Deputy Commissioner, 13th Compensation District, U. S. Employees Compensation Commission, filed March 31, 1942.

5. Copy of Minute Order of Court of April 14, 1942.

6. Copy of Minute Order of Court of May 4, 1942.

7. Copy of Minute Order of Court of June 10, 1942.

8. Memorandum of Conclusions filed August 19, 1942.

9. Copy of Minute Order of Court of August 19, 1942. [109]

10. Objections of Hillcone Steamship Company, a corporation, Santa Cruz Oil Company, a corporation, and Associated Indemnity Corporation, a corporation, to Findings of Fact and Conclusions of Law.

11. Objections of Hillcone Steamship Company, a corporation, Santa Cruz Oil Company, a corporation, and Associated Indemnity Corporation, a corporation, to Proposed Decree.

12. Findings of Fact and Conclusions of Law.

13. Decree.

14. Petition for Appeal.

15. Order allowing Appeal.

16. Costs Bond on Appeal.

17. Citation.

18. Designation of Parts of Apostles on Appeal and Praeceptum.

In making up the record to be transmitted to the Circuit Court of Appeals, the Clerk of the District Court will please omit all formal captions and titles, except the caption upon the libel in personam, substituting in the case of omitted caption the words "Title of Court and Cause"; that he shall omit all verifications, substituting therefor the word "verified".

It is hereby requested that the record on appeal be prepared in accordance with the foregoing demand and praecipe and certified to the United States Circuit Court of Appeals for the Ninth Circuit.

Dated January 19, 1943.

S. S. TIPTON,

A. G. RITTER,

Proctors for Respondents.

[Endorsed]: Filed Jan. 19, 1943. [110]

[Title of District Court and Cause.]

COUNTERDESIGNATION OF RECORD ON
APPEAL AND PRAECIPE

Now comes the libelant, Albert V. Steffen, and designates the following additional parts of apostles on appeal in the above-entitled matter:

1. Libelant's Reply to Objections to the Proposed Decree.
2. Libelant's Reply to Objections to Findings of Fact and Conclusions of Law.

It is hereby requested that the record on appeal

be prepared in accordance with the foregoing demand and praecipe and certified to the United States Circuit Court of Appeals for the Ninth Circuit.

Dated: January 22, 1943.

WM. P. LORD and
FONTANA & GOLDSTONE,
By A. A. GOLDSTONE,
Proctors for Libelant.

Received copy of within Counterdesignation of Record on Appeal this ____ day of January, 1942.

WILLIAM FLEET PALMER,
United States Attorney, and
HOWARD V. CALVERLEY,
Asst. U. S. Atty.

[Endorsed]: Filed Jan. 22, 1943. [111]

[Title of District Court and Cause.]

ASSIGNMENTS OF ERROR OF HILLCONE STEAMSHIP COMPANY, a corporation, SANTA CRUZ OIL COMPANY, a corporation, and ASSOCIATED INDEMNITY COMPANY, a corporation.

Hillcone Steamship Company, a corporation, Santa Cruz Oil Company, a corporation, and Associated Indemnity Corporation, a corporation, and each of them, appellants herein, assign the following errors in the record and proceedings in this

cause, in the decision and findings of fact and conclusions of law herein, and in the final decree of the District Court of the United States for the Southern District of California, Central Division, entered herein on November 10, 1942:

I.

The Court erred in finding that the libelant, Albert V. Steffen, was entitled to a decree herein against respondents, Hillcone Steamship Company, a corporation, Santa Cruz Oil Company, a corporation, and Associated Indemnity Corporation, a corporation.

II.

The Court erred in not directing that the libel of the libelant should be dismissed.

III.

The Court erred in finding that the service or employment of Albert V. Steffen, libelant, was maritime in character. [112]

IV.

The Court erred in finding that Albert V. Steffen, libelant, sustained certain injuries while engaged in the performance of his duties as a watchman on the S. S. Prentiss.

V.

The Court erred in finding that recovery for disability through Workmen's Compensation proceedings may not validly be provided by State Law.

VI.

The Court erred in finding that libelant is entitled to relief under the Longshoremen's and Harbor Workers' Compensation Act.

VII.

The Court erred in remanding said cause for the sole purpose of fixing the compensation due to libelant, Albert V. Steffen, by respondents, Santa Cruz Oil Company, a corporation, and Associated Indemnity Corporation, a corporation, and each of them.

VIII.

The Court erred in directing that additional testimony be taken by the Deputy Commissioner, 13th Compensation District, U. S. Employees Compensation Commission for the sole purpose of fixing the Compensation due to libelant, Albert V. Steffen, in order to determine the amount thereof.

IX.

The Court erred in directing the U. S. Employees Compensation Commission to fix the compensation due the attorneys for libelant for services rendered in this proceeding.

X.

The Court erred in directing that libelant recover from respondents, Santa Cruz Oil Company, a corporation, and Associated Indemnity Corporation, a corporation, his costs herein expended. [113]

XI.

The Court erred in finding that libelant sustained an injury and that at the time of sustaining his injuries libelant was engaged in maritime employment upon navigable waters of the United States.

XII.

The Court erred in finding that at the time of sustaining said injuries libelant was engaged in the performance of the duties of such employment.

XIII.

The Court erred in finding that the present disability of libelant arose from injuries received in the course of his employment.

XIV.

The Court erred in finding that the U. S. Employees Compensation Commission has jurisdiction of said cause.

XV.

The Court erred in finding, making and entering its decree against respondents, Santa Cruz Oil Company, a corporation, and Associated Indemnity Corporation, a corporation, and each of them.

Dated: January 18, 1943.

HILLCONE STEAMSHIP
COMPANY, a Corporation,
SANTA CRUZ OIL COMPANY,
a Corporation,

ASSOCIATED INDEMNITY
CORPORATION, a Corpora-
tion,

Appellants.

S. S. TIPTON,

A. G. RITTER,

Attorneys for Appellants.

[Endorsed]: Filed Jan. 18, 1943. [114]

In the United States Circuit Court of Appeals
For the Ninth Circuit

No. 1790-H

HILLCONE STEAMSHIP COMPANY, a corp.,
SANTA CRUZ OIL COMPANY et al.,
Appellants,

vs.

ALBERT V. STEFFEN,

Appellee.

CITATION

United States of America—ss.

To Albert V. Steffen, Greeting:

You are hereby cited and admonished to be and appear at a United States Circuit Court of Appeals for the Ninth Circuit, to be held at the City of San Francisco, in the State of California, on the 27th day of February, A. D. 1943, pursuant to an order allowing appeal filed on Jan. 18, 1943, in the Clerk's Office of the District Court of the United States, in and for the Southern District of California, in that certain cause No. 1790-H, Central

Division, wherein Hillcone Steamship, a Corporation, Santa Cruz Oil Company, a Corporation, and Associated Indemnity Corporation, a Corporation, is/are appellants and you are appellee to show cause, if any there be, why the decree, order or judgment in the said appeal mentioned, should not be corrected, and speedy justice should not be done to the parties in that behalf.

Witness, the Honorable H. A. Hollzer, United States District Judge for the Southern District of California, this 18th day of January, A. D. 1943, and of the Independence of the United States, the one hundred and sixty-sixth.

H. A. HOLLZER,

United States District Judge
for the Southern District of
California.

Receipt of copy of petition for appeal, assgts of error & order allowing appeal & Service of a copy of the foregoing Citation is acknowledged this 18th day of January.

WM. P. LORD and
FONTANA & GOLDSTONE,

By (Illegible)

Attorney for Appellee.

LEO V. SILVERSTEIN,

U. S. Atty.

HOWARD V. CALVERLEY,

Asst. U. S. Atty.

Attorney for Warren A. Pillsbury, etc., Respondent.

[Endorsed]: Filed Jan. 19, 1943.

In the District Court of the United States, Southern District of California, Central Division

No. 1790-H-Adm.

ALBERT V. STEFFEN,

Libelant,

vs.

HILLCONE STEAMSHIP COMPANY, a corporation, SANTA CRUZ OIL COMPANY, a corporation, ASSOCIATED INDEMNITY CORPORATION, a corporation, and WARREN A. PILLSBURY, Deputy Commissioner, 13th Compensation District, U. S. Employees Compensation Commission,

Respondents.

CERTIFICATE OF CLERK TO TRANSCRIPT
OF RECORD

I, Edmund L. Smith, Clerk of the District Court of the United States for the Southern District of California, do hereby certify that the foregoing pages numbered from 1 to 114 inclusive contain full, true and correct copies of: Libel in Personam; Answer to Libel in Personam; Answer of Respondent Warren A. Pillsbury, Deputy Commissioner, United States Employees' Compensation Commission to Libel in personam; Minute Order Entered April 14, 1942; Minute Order Entered May 4, 1942; Certified Copy of Record of Warren A. Pillsbury, Deputy Commissioner, 13th Compensation District,

U. S. Employees Compensation Commission; Minute Order Entered June 10, 1942; Minute Order Entered August 19, 1942; Memorandum of Conclusions; Objections to Findings of Fact and Conclusions of Law; Reply to Objections to Findings of Fact and Conclusions of Law; Objections to the Proposed Decree; Reply to Objections to the Proposed Decree; Findings of Fact and Conclusions of Law; Decree; Petition for Appeal and Order Allowing Appeal; Costs Bond on Appeal; Designation of Parts of Apostles on Appeal and Praecipe; Counterdesignation of Record on Appeal and Praecipe and Assignments of Error which, together with original Citation annexed hereto, constitute the apostles on appeal to the United States Circuit Court of Appeals for the Ninth Circuit.

I further certify that the fees of the clerk for comparing, correcting and certifying the foregoing record amount to \$27.60 and that said amount has been paid to me by Appellants.

Witness my hand and the seal of the said District Court this 4 day of February, A. D. 1943.

(Seal)

EDMUND L. SMITH,

Clerk.

By THEODORE HOCKE,

Deputy Clerk.

[Endorsed]: No. 10361. United States Circuit Court of Appeals for the Ninth Circuit. Hillcone Steamship Company, a corporation, Santa Cruz Oil Company, a corporation and Associated Indemnity Corporation, a corporation, Appellants, vs. Albert V. Steffen, Appellee. Apostles on Appeal Upon Appeal from the District Court of the United States for the Southern District of California, Central Division.

Filed February 6, 1943.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

In the United States Circuit Court of Appeals for
the Ninth Circuit

No. 10361

HILLCONE STEAMSHIP COMPANY, a corporation;
SANTA CRUZ OIL COMPANY, a corporation; et al.,

Appellants,

vs.

ALBERT V. STEFFEN,

Appellee.

APPELLANTS STATEMENT OF POINTS AND
DESIGNATION OF PARTS OF RECORD

The following is a statement of the points upon which the appellants intend to rely upon their appeal herein:

1. The libelant was not engaged in a maritime employment.

2. Since the employment of libelant was not maritime in character the U. S. Employees Compensation Commission has no authority nor jurisdiction to grant libelant relief.

3. The power of the District Court was limited to the determination of whether or not the occupation of libelant was maritime in character.

4. That the Commissioner did not find that libelant had been injured or that his alleged or claimed injuries were received in the course of his employment.

5. That since the Commissioner made no finding as to whether libelant had been injured or whether his alleged or claimed injuries were sustained in the course of his employment the Court erred in directing that a hearing be had by the Commissioner on the sole issue of finding the amount of compensation due libelant.

6. That if said employment of libelant shall be held to be maritime in character it is the duty of the Commission and not of the District Court to determine the fact of injury and whether or not such injury was incurred in the course of the employment.

7. That the finding of the Commissioner that the employment of libelant and his occupation were not maritime in character, was supported by the evidence before him and was correct.

8. That the District Court erred in directing that attorneys fees be allowed to attorneys for libelant.

9. That the District Court erred in holding that the employment or occupation of libelant was maritime in character.

The Appellants hereby designate the following parts of the record which they think necessary for a consideration of the foregoing points:

Name of Document:

1. Libel in personam.
2. Answer of Hillcone Steamship Company, a corporation; Santa Cruz Oil Company, a corporation; and Associated Indemnity Corporation, a corporation; and each of them.
3. Answer of Warren A. Pillsbury, Deputy Commissioner, 13th Compensation District, U. S. Employees Compensation Commission.
4. Certified copy of record of Warren A. Pillsbury, Deputy Commissioner, 13th Compensation District, U. S. Employees Compensation Commission, filed March 31, 1942.
5. Copy of minute order of Court of April 14, 1942.
6. Copy of minute order of Court of May 4, 1942.
7. Copy of minute order of Court of June 10, 1942.
8. Memorandum of Conclusions filed August 19, 1942.
10. Objections of Hillcone Steamship Co. etc. et al to Findings of Fact and Conclusions of Law.
11. Objections of Hillcone Steamship Company etc. et al to proposed Decree.
12. Findings of Fact and Conclusions of Law.

13. Decree.
14. Petition for Appeal.
15. Order allowing Appeal.
16. Costs Bond on Appeal.
17. Citation.
18. Assignments of Error of Hillcone Steamship Company, a corporation, Santa Cruz Oil Company, a corporation, and Associated Indemnity Corporation, a corporation.
19. Designation of Parts of Apostles on Appeal and Praecipe.
20. Appellants Statement of Points and Designations of Parts of Record.

Dated: February 1, 1943.

S. S. TIPTON &
A. G. RITTER,

Proctors for Appellants, Hillcone Steamship Company, a corporation; Santa Cruz Oil Company, a corporation; and Associated Indemnity Corporation, a corporation.

Received copy of the within instrument this 1st day of February, 1943.

FONTANA & GOLDSTONE &
WM. P. LORD.

By A. A. GOLDSTONE,
By JUNE L. TROXEL,

Attorneys for Appellee.

Received copy of the within this 1 day of Feb., 1943.

(Illegible)

Asst. U. S. Atty.

[Endorsed] Filed Feb. 6, 1943. Paul P. O'Brien, Clerk.

[Title of Circuit Court of Appeals and Cause.]

APPELLEE'S COUNTERDESIGNATION
OF PARTS OF RECORD

The Appellee hereby designates the following additional parts of the record which he thinks necessary for consideration of the points on appeal herein:

1. Appellee's (Libelant's) Reply to Objections to the Proposed Decree.
2. Appellee's (Libelant's) Reply to Objections to Findings of Fact and Conclusions of Law.
3. Appellee's Counterdesignation of Record on Appeal and Praeceptum.

Dated: February 8, 1943.

WM. P. LORD and
FONTANA & GOLDSTONE
By A. A. GOLDSTONE
Proctors for Appellee.

Received copy of the within Appellee's Counter-designation of Parts of Record this ---- day of February, 1943.

S. S. TIPTON and
A. G. RITTER
By S. S. TIPTON
Attorneys for Appellants

(Affidavit of Service by Mail on Warren A. Pillsbury.)

[Endorsed]: Filed Feb. 10, 1943. Paul P. O'Brien, Clerk.

No. 10361

IN THE

United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

HILLCONE STEAMSHIP COMPANY, a corporation, SANTA
CRUZ OIL COMPANY, a corporation and ASSOCIATED
INDEMNITY CORPORATION, a corporation,

Appellants,

vs.

ALBERT V. STEFFEN,

Appellee.

APPELLANTS' OPENING BRIEF.

S. S. TIPTON,
975 Subway Terminal Building, Los Angeles,

A. G. RITTER,
915 Black Building, Los Angeles,

Attorneys for Appellants.

FILED

APR 2 - 1943

TOPICAL INDEX.

	PAGE
Statement of case.....	1
Statement of pleadings and facts.....	4
Specification of assigned errors.....	7
Steffen's employment was not maritime in character.....	7
The employment of Steffen was not maritime in character and the ruling of the deputy commissioner was correct.....	9
Since the alleged claim of Steffen arose from contact and not from tort his remedy was not under the Admiralty laws but under the California laws.....	10
Recovery should be sought by Steffen under state and not under federal laws	13
The District Court should have limited its decision to a deter- mination of the maritime question. The assignments of error on that argument are as follows:.....	19
Conclusion	23

TABLE OF AUTHORITIES CITED.

CASES.	PAGE
Crowell v. Benson, 285 U. S. 22.....	23
Davis v. Department of Labor and Industries of the State of Washington, 87 L. ed. Adv. Ops. 175; 63 Sup. Ct. Rep. 225; U. S. Law Week 4059.....	13, 18
Employers' Liability Assurance Corporation, etc. v. Industrial Accident Commission, 177 Cal. 775.....	11
Grant Smith-Porter Ship Company v. Rhode, 257 U. S. 469, 66 L. ed. 321, 42 Sup. Ct. Rep. 157.....	10, 12
Gurney v. Crockett, Fed. Cas. No. 5874, 11 Fed. Cases 123.....	9
Jones v. International Mercantile Marine Co., 277 N. Y. 640, 14 N. E. (2d) 198.....	13
New Amsterdam Casualty Co. v. McMaugal, 87 Fed. (2d) 332	13
Puget Sound Nav. Co. v. Marshall, 31 Fed. (2d) 903.....	10
Shipbuilding etc. Co. v. Industrial Accident Commission, 57 Cal. App. 355	12
South Chicago Coal & Dock Co. v. Bassett, 309 U. S. 251.....	22
Southern Pacific Company v. Jensen, 244 U. S. 205, 61 L. ed. 1086, 37 Sup. Ct. Rep. 524.....	13, 14, 15, 17
The Fortuna, 206 Fed. 573.....	9
The Poznan, 9 Fed. (2d) 838.....	9
The Sirius, 65 Fed. 226.....	9
The William Leishear, 21 Fed. (2d) 863.....	9
Volhn v. Indemnity Insurance Co., 288 U. S. 162.....	22
Williams v. American Employers Ins. Co., 107 Fed. (2d) 953, cert. den. 309 U. S. 682.....	23

STATUTES.

Federal Constitution, Art. III, par. 2.....	14
Labor Code of California, Secs. 3201 to 6002, incl.....	11
Longshoremen's and Harbor Worker's Compensation Act, 44 Stat. at L. 1424, Chap. 209, 33 U. S. C., Sec. 901.....	7, 15

No. 10361

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

HILLCONE STEAMSHIP COMPANY, a corporation, SANTA
CRUZ OIL COMPANY, a corporation and ASSOCIATED
INDEMNITY CORPORATION, a corporation,

Appellants,

vs.

ALBERT V. STEFFEN,

Appellee.

APPELLANTS' OPENING BRIEF.

Statement of Case.

Albert V. Steffen, appellee herein, was employed by the Santa Cruz Oil Company, a California corporation, as a watchman on the Steamship Prentiss. The Steamship Prentiss was owned by the Santa Cruz Oil Company. Hillcone Steamship Company, was neither the owner of the Prentiss nor the employer of Steffen and had nothing to do with any of the matters involved in this action. No judgment was taken against said Hillcone Steamship Company and it is in the same position as if said action had been abandoned as to it. The Associated Indemnity Corporation was the insurance carrier for said Santa Cruz Oil Company. Said company owned the steamship Prentiss for about two and one-half years. She never

went to sea during that time and was not in service. Later she was sold to the Craig Shipyards at Long Beach, California and scrapped. She was purchased by the Santa Cruz Oil Company to be reconditioned and fixed up as a tender ship for the fishing reduction plants which were operating out of San Francisco off the Ferralone Islands. Steffen never performed any other job aboard the boat except as watchman. He lived on shore most of the time but he had a bunk and electric heater on the boat. The ship was tied up at the Craig Shipyards in Long Beach. Steffen claimed that he was injured in coming off the ship; that there was a ladder from the bow of the ship to a sort of pontoon that was connected with the dry dock and that when he was going down the ladder he fell and sustained injuries to his back. He claims to have fallen onto the pontoon which was afloat in the dry dock. There was a dispute in the evidence as to whether or not he actually fell and as to whether or not he actually received injuries. It was claimed by the insurance carrier and the employer that his condition was due to arthritis and natural causes and that he never sustained an accident.

Steffen filed a claim for compensation with the U. S. Employees Compensation Commission under the Longshoremen's and Harbor Workers' Compensation Act. Issue was joined and hearing was had before Hon. Warren A. Pillsbury, Deputy Commissioner. Evidence was introduced at said hearing which was continued from time to time and at the conclusion thereof the Deputy Commissioner found as follows:*

*In all cases italics are ours.

“That during the month of February, 1937 the claimant above named was in the employ of the employer above named, Santa Cruz Oil Company, at Long Beach, in the State of California, in the 13th Compensation District, established under the provisions of the Longshoremen’s and Harbor Workers’ Compensation Act, and that the liability of the employer for compensation under said Act was insured by the Associated Indemnity Corporation:

“That claimant contends that about said time he sustained injured to his back by the slipping of a ladder extending from a pontoon to said ship, while he was leaving said ship in the course of his work;

“That at said time claimant was employed as a watchman or caretaker on board the S. S. Prentiss and had been so employed for more than two years. That said vessel did not go to sea or engage in commerce or navigation at any [87] time during said period. That there was no crew on board during said time. That said vessel had been purchased by the employer with the intention of reconditioning and remodeling her for service in connection with certain fish reduction plants but that the employer eventually sold said vessel without putting her into use in such or any capacity as a vessel. That at the time of said injury said vessel was indefinitely laid up. That claimant’s employment as said watchman and caretaker was not maritime in character.”

The Commissioner thereupon rejected said claim and held that claimant’s service at the time of his alleged injury was not maritime in character, and that claimant does not come within the provisions of the Longshoremen’s and Harbor Workers’ Compensation Act.

The order rejecting claim and findings of the Deputy Commissioner are set forth at pages 85 and 86 of the Apostles on Appeal.

This Court has jurisdiction to entertain an appeal from a final judgment in an admiralty proceeding.

Statement of Pleadings and Facts.

Thereafter Steffen filed a libel in *personam* on the Admiralty side of the Court in the U. S. District Court for the Southern District of California, Central Division. [Apostles on Appeal, p. 2.] A joint answer was filed on behalf of the respondents Hillcone Steamship Company, a corporation, Santa Cruz Oil Company, a corporation, and Associated Indemnity Corporation, a corporation. [Apostles on Appeal, p. 11, *et seq.*] A separate answer was filed on behalf of respondent Warren A. Pillsbury, Deputy Commissioner. [Apostles on Appeal, p. 14, *et seq.*]

The issues framed by the pleadings were generally whether or not the Deputy Commissioner erred in finding that the employment of Steffen was not maritime in character and hence not subject to the Longshoremen's & Harbor Workers' Compensation Act, and erred in rejecting said claim of Steffen.

When the case came on for hearing in the District Court upon stipulation of counsel and order of court the cause was heard on the record as certified by the Commissioner. [Apostles on Appeal, p. 18.] Said record

contained the entire file of the proceedings including the testimony had before said Deputy Commissioner. [Apostles on Appeal, pp. 19 to 87, incl.] Briefs were filed in the District Court on behalf of the various litigants and after submission of the case the judge of the said District Court made his findings and in accordance therewith entered his decree as follows [Apostles on Appeal, pp. 102 to 104]:

“The above entitled action came on regularly to be heard on the 10th day of June, 1942, before the above entitled Court, the Honorable Harry A. Hollzer, Judge Presiding, without a jury, the libelant appearing by his attorneys, William P. Lord and Fontana & Goldstone, A. A. Goldstone of counsel, the respondents Hillcone Steamship Company, Santa Cruz Oil Company, and Associated Indemnity Corporation appearing by their attorney, Cyril S. Tipton and the respondent Warren A. Pillsbury, Deputy Commissioner, 13th Compensation District, U. S. Employees Compensation Commission, appearing by William Fleet Palmer, United States Attorney and Howard V. Calverley, Assistant United States Attorney, Howard A. Calverley of counsel; the parties hereto, through their respective counsel, having stipulated that the liability of the respondents be determined on the issue of whether or not the service or employment of the libelant, at the time he admittedly was injured, was maritime in character, and the cause having been submitted on the record as certified by the Deputy Commissioner and upon the stipulations, oral

arguments and briefs of counsel [104] and the court being fully advised in the premises, and having made its Findings of Fact and Conclusions of Law,

“It Is Hereby Ordered, Adjudged and Decreed as Follows:

“That libelant is entitled to relief under the Longshoremen’s and Harbor Workers’ Compensation Act.

“That this cause be remanded to the Deputy Commissioner, 13th Compensation District, U. S. Employees Compensation Commission for the sole purposes of fixing the compensation due to libelant, Albert V. Steffen, by respondents Santa Cruz Oil Company and Associated Indemnity Corporation, and each of them, and, if necessary to take additional testimony in relation to such compensation in order to determine the amount thereof, and to fix the compensation due attorneys for libelant for services rendered in this proceeding.

“It is further ordered that libelant recover from respondents Santa Cruz Oil Company and Associated Indemnity Corporation his costs herein expended, the same to be taxed by the clerk of this Court.

“Dated November 9, 1942.

“H. A. HOLLZER,

“U. S. District Judge.”

Thereafter the necessary steps were taken for this appeal.

Specification of Assigned Errors.

The assigned errors relied upon are the following: Numbers I to XV, inclusive, printed on pages 112, 113, and 114 of the Apostles on Appeal. (Some of these assignments are overlapping in character but we shall in our brief attempt to group them in the proper manner.)

Steffen's Employment Was Not Maritime in Character.

This case involves the correctness of a decision by the Commissioner under the *Longshoremen's and Harbor Workers' Compensation Act*, 44 Stat. at L. 1424, Chap. 209, 33 U. S. C. Sec. 901, *et seq.* The decision held that Steffen, the claimant could not recover in his proceedings before the Commissioner, because claimant's employment as a watchman and caretaker was not maritime in character.

The assignments of error relating to this phase of the case are as follows:

I.

"The Court erred in finding that the libelant, Albert V. Steffen, was entitled to a decree herein against respondents, Hillcone Steamship Company, a corporation, Santa Cruz Oil Company, a corporation, and Associated Indemnity Corporation, a corporation."

II.

"The Court erred in not directing that the libel of the libelant should be dismissed."

III.

“The Court erred in finding that the service or employment of Albert V. Steffen, the libelant, was maritime in character. [112.]”

VI.

“The Court erred in finding that libelant is entitled to relief under the Longshoremen’s and Harbor Workers’ Compensation Act.”

IX.

“The Court erred in directing the U. S. Employees Compensation Commission to fix the compensation due the attorneys for libelant for services rendered in this proceeding.”

X.

“The Court erred in directing that libelant recover from respondents, Santa Cruz Oil Company, a corporation, and Associated Indemnity Corporation, a corporation, his costs herein expended. [113.]”

XIV.

“The Court erred in finding that the U. S. Employees Compensation Commission has jurisdiction of said cause.”

XV.

“The Court erred in finding, making and entering its decree against respondents, Santa Cruz Oil Company, a corporation, and Associated Indemnity Corporation, a corporation, and each of them.” [Apostles on Appeal, pp. 112-113-114.]

• The above named assignments of error are interrelated and all raise the main question in this proceeding, namely, whether or not Steffen was entitled to the benefits of the Longshoremen’s and Harbor Workers’ Compensation Act.

The same question is raised by the statement of points on appeal printed in the *Apostles on Appeal* at pages 120 to 121, as follows:

“1. The libelant was not engaged in a maritime employment.

“2. Since the employment of libelant was not maritime in character the U. S. Employees Compensation Commission has no authority nor jurisdiction to grant libelant relief.

“7. That the finding of the Commissioner that the employment of libelant and his occupation were not maritime in character, was supported by the evidence before him and was correct.

“8. That the District Court erred in directing that attorneys’ fees be allowed to attorneys for libelant.

“9. That the District Court erred in holding that the employment or occupation of libelant was maritime in character.”

The Employment of Steffen Was Not Maritime in Character and the Ruling of the Deputy Commissioner Was Correct.

See the following authorities on the proposition that a watchman on vessels not in service is not in a maritime occupation.

The Fortuna, 206 Fed. 573;

Gurney v. Crockett, Fed. Case No. 5874, 11 Fed. Cases 123;

The Sirius, 65 Fed. 226;

The Poznan, 9 Fed. (2d) 838;

The William Leishcar, 21 Fed. (2d) 863.

Since the Alleged Claim of Steffen Arose From Contact and Not From Tort His Remedy Was Not Under the Admiralty Laws but Under the California Laws.

The alleged injuries arose by reason of contract and not by reason of tort. Steffen was employed to act as a watchman on the S. S. Prentiss which was at all times tied up to the dock. No negligence is claimed. He claims he fell off a ladder which went from the ship to a float attached to the dock while he was going to answer the telephone. Because of his contract of employment he claims recovery and not otherwise. His duties were to be a watchman on a vessel which was not going to sea nor being used by his employer for the doing of any maritime business. During all times of his employer's ownership the vessel was out of service. His alleged injuries were not received in the course of employment under a maritime contract or while the alleged injured servant was performing work of an essentially maritime character. We believe the *Puget Sound Nav. Co. v. Marshall*, 31 Fed. (2) 903 case comes within the doctrine of *Grant Smith-Porter Ship Company v. Rhode*, 257 U. S. 469, 66 L. ed. 321, 42 Sup. Ct. Rep. 157. That case holds that "*in contract matters, admiralty jurisdiction depends upon the nature of the transaction, and, in matters of tort, upon the locality.*" The court says in speaking of the text of jurisdiction as follows:

"The general doctrine that, in contract matters, admiralty jurisdiction depends upon the nature of the transaction, and in tort matters upon the locality, has been so frequently asserted by this court that it must now be treated as settled. *Waring v. Clark*, 5 How. 441, 459, 12 L. ed. 226, 235; *Philadelphia*,

W. & B. R. Co. v. Philadelphia & H. de G. Steam Towboat Co., 23 How. 209, 215, 16 L. ed. 433, 435; The Commerce (Commercial Transp. Co. v. Fitzhugh), 1 Black, 574, 579, 17 L. ed. 107, 109; The Plymouth (Hough v. Western Transp. Co.), 3 Wall. 20, 33, 18 L. ed. 125, 127; Leathers v. Blessing, 105 U. S. 626, 630, 26 L. ed. 1192, 1194; Martin v. West, 222 U. S. 191, 197, 56 L. ed. 159, 162, 36 L. R. A. (N. S.) 592, 32 Sup. Ct. Rep. 42. See Atlantic Transport Co. v. Imbrovek, 234 U. S. 52, 59, 58 L. ed. 1208, 1211, 51 L. R. A. (N. S.) 1157, 34 Sup. Ct. Rep. 733, and Hughes, Admiralty, 2d ed. p. 195."

Under the ruling of the cited cases this was not an admiralty matter. We believe the action should not have been on the admiralty side of the court.

Steffen had a remedy under the California Workmen's Compensation Act. The alleged injuries occurred in California. The employer was a California corporation and (unless the proceeding is barred by the Federal law) was subject to the Workmen's Compensation Act of California.

Labor Code of the State of California, Sections 3201 to 6002, inclusive.

Sec. 21, Art. XX of the Constitution of the State of California authorizes the legislature to "create and enforce a liability on the part of all employers to compensate their employees for any injuries received by said employees in the course of their employment. Employers' Liability Assurance Corporation, etc. v. Industrial Accident Commission, 177 Cal. 775.

We, therefore, have a situation here where there was jurisdiction in the State court and where Steffen had a right to proceed against his employer under the Workmen's Compensation Statutes of California. The finding of the District Court "that recovery of such disability through Workmen's Compensation proceedings may not validly be provided by State law" [Apostles on Appeal, page 101] was erroneous. The District Court decided the case on the theory that such employment was of a maritime nature and therefore not subject to the state laws. The courts of the State of California have affirmed the ruling above quoted in *Grant Smith-Porter Ship Company v. Rhode, supra*. In the case of *Shipbuilding etc. Co. v. Industrial Accident Commission*, 57 Cal. App. 355, the court decides as follows:

"In determining whether a contract be maritime *the test is, not locality, as in the case of torts, but the subject matter of the contract—the nature of the work to be done.* (Doey v. Clarence P. Howland Co., 224 N. Y. 30 (120 N. E. 53).) 2. A contract for the construction of a vessel is nonmaritime and not within the admiralty jurisdiction. (Thames Towboat Co. v. Francis McDonald, 254 U. S. 242 (65 L. Ed. 245, 41 Sup. Ct. Rep. 65); *Grant Smith-Porter Ship Co. v. Rhode*, 257 U. S. 469 (66 L. Ed. 321, 42 Sup. Ct. Rep. 157).) Although the uncompleted vessel upon which he was hurt was lying in navigable waters, Toutain's services were not of a maritime nature. Neither his general employment nor his activities at the time had any direct relation to navigation or commerce. (*Grant Smith-Porter Ship Co. v. Rhode, supra*.)"

See also:

New Amsterdam Casualty Co. v. McMaughal, 87
Fed. (2d) 332;

Jones v. International Mercantile Marine Co., 277
N. Y. 640, 14 N. E. (2d) 198.

Assignment of error number V reads as follows:

“The Court erred in finding that recovery for disability through Workmen’s Compensation proceedings may not validly be provided by State Law.”
[Apostles on Appeal, page 112.]

Recovery Should Be Sought by Steffen Under State and Not Under Federal Laws.

The leading case on matters of this nature is *Southern Pacific Company v. Jensen*, 244 U. S. 205, 61 L. ed. 1086, 37 Sup. Ct. Rep. 524. A comprehensive note as to the applicability of State Compensation Acts to injuries within admiralty jurisdiction appears in a note to 25 A. L. R. 1029. That note discusses the effect of the various state statutes prior to the decision in the *Jensen* case and subsequent thereto. In a very recent case, however, the U. S. Supreme Court, speaking through Justice Black, criticizes the *Jensen* decision and interprets it with reference to the Compensation Statutes of the State of Washington. The recent case is entitled *Davis v. Department of Labor and Industries of the State of Washington*, 87 L. ed. Adv. Ops. 175; 63 Sup. Ct. Rep. 225; U. S. Law Week 4059. (No. 86, decided December 14, 1942.)

Davis, a structural steel worker, was employed by a construction company, to work on a job which involved the dismantling of an abandoned drawbridge which crossed

a navigable river in the State of Washington. Part of that work involved the cutting away of the steel of the bridge with oxyacetylene torches and when loaded in barges cutting the steel again into suitable lengths for transportation. While engaged on this work he fell into the navigable stream and was drowned.

A Washington statute provides compensation for employees and their dependents if its application can be made "within the legislative jurisdiction of the state" and further provides coverage of the Act to "all employers or workmen . . . engaged in maritime occupations for whom no right or obligation exists under the maritime laws." A line of opinions of the Supreme Court beginning with *So. Pac. Co. v. Jensen*, 244 U. S. 205, 216, held that under some circumstances states could, but under others could not, consistent with Article III, par. 2 of the Federal Constitution, apply their compensation laws to maritime employees. State legislation was declared to be invalid when it works "material prejudice to the characteristic features of the general maritime law or interferes with the proper harmony and uniformity of that law in its international and interstate relations." When a state could, and when it could not, grant protection under a compensation act, was left as a "perplexing problem".

To remove uncertainty so that workers whose duties were partly on land and partly on navigable waters might be compensated for injuries, Congress soon after the *Jensen* decision passed an act giving such injured persons "the rights and remedies under the Workmen's Compensation law of any state". That Act was declared unconstitutional. Congress made another effort to permit

state compensation laws to protect that class of employees but this second act was also held invalid. Then followed the Federal Longshoremen's and Harbor Worker's Act, 33 U. S. C. Sec. 901 *et seq.*, which made clear the purpose of Congress to permit state compensation protection whenever possible by making the federal law applicable only "if recovery for the disability or death through workmen's compensation proceedings may not validly be provided by law."

Application was made by the decedent's widow under the state law. The Supreme Court of the State of Washington held that the state could not consistently with the Federal Constitution as construed in the *Jensen* case make an award under its state compensation law to the widow of a workman drowned in a navigable river.

Certiorari was allowed to review the decision of the State Supreme Court and the judgment of the State Court was reversed.

The opinion of the court was delivered by Mr. Justice Black. After reviewing the provisions of the state and federal statutes and the course of the case through the courts below, the opinion says:

"Harbor workers and longshoremen employed 'in whole or in part upon the navigable waters' are clearly protected by this Federal Act; but, employees such as decedent here occupy that shadowy area within which, at some undefined and undefinable point, state laws can validly provide compensation. This Court has been unable to give any guiding, definite rule to determine the extent of state power in advance of litigation, and has held that the margins

of state authority must 'be determined in view of the surrounding circumstances as cases arise.' . . . The determination of particular cases, of which there have been a great many, has become extremely difficult. It is fair to say that a number of cases can be cited both in behalf of and in opposition to recovery here."

As to the difficulties which these uncertainties impose on the employee, Mr. Justice Black says:

"It must be remembered that under the Jensen hypothesis, basic conditions are factual: Does the state law 'interfere with the proper harmony and uniformity of' maritime law? Yet employees are asked to determine with certainty before bringing their actions that factual question over which courts regularly divide among themselves and within their own membership. As penalty for error, the injured individual may not only suffer serious financial loss through the delay and expense of litigation, but discover that his claim has been barred by the statute of limitations in the proper forum while he was erroneously pursuing it elsewhere."

As to those likewise imposed on the employees, it is said:

"The horns of the jurisdictional dilemma press as sharply on employers as on employees. In the face of the cases referred to above the most competent counsel may be unable to predict on which side of the line particular employment will fall. The employer's contribution to a state insurance fund may therefore wholly fail to protect him against the liabilities for which it was specifically planned."

Stating the considerations which seem to suggest that the constitutional questions involved in the *Jensen* case should not now be re-examined, Mr. Justice Black says:

“We are not asked here to review and reconsider the constitutional implications of the *Jensen* line of decisions. On the contrary, even the petitioner argues that such action might bring about still worse confusion in an already uncertain field, and points out that state and federal agencies have made real progress toward closing the gap.

The Longshoremen’s Act passed with specific reference to the *Jensen* rule, provided a partial solution. The Washington statute represents a state effort to clarify the situation. Both of these laws show clearly that neither was intended to encroach on the field occupied by the other. But the line separating the scope of the two being undefined and undefinable with exact precision, marginal employment may, by reason of particular facts, fall on either side.

There is, in the light of the cases referred to, clearly a twilight zone in which the employees must have their rights determined case by case, and in which particular facts and circumstances are vital elements. That zone includes persons such as the decedent who are, as a matter of actual administration, in fact protected under the state compensation act.

We find here a state statute which purports to cover these persons, and which indeed does cover them if the doubtful and difficult factual questions to which we have referred are decided on the side of the constitutional power of the state.

In making the factual judgment there, we have relied heavily on the presumption of constitutionality in favor of the state statute.”

Mr. Justice Black closes the statement of his final conclusion as follows:

“Not only does the state act in the instant case appear to cover this employee, aside from the constitutional consideration, but no conflicting process of administration is apparent. The federal authorities have taken no action under Longshoremen’s Act, and it does not appear that the employer has either made the special payments required or controverted payment in the manner prescribed in the Act. . . . Under all the circumstances of this case we will rely on the presumption of constitutionality in favor of this state enactment; for any contrary decision results in our holding the Washington act unconstitutional as applied to this petitioner. A conclusion of unconstitutionality of a state statute can not be rested on so hazardous a factual foundation here any more than in the other cases cited.

Giving the full weight to the presumption, and resolving all doubts in favor of the Act, we hold that the Constitution is no obstacle to the petitioner’s recovery. The case is remanded for proceedings not inconsistent with this opinion.”

(In a discussion of the above case we have used the review published and the language appearing in a recent issue of the American Bar Journal.)

In the case at bar the facts were determined by the Deputy Commissioner and such determination should be binding on the District Court.

Under the ruling of the *Davis* case and the finding of the Deputy Commissioner, we respectfully submit that the claimant Steffen should seek relief under the California statute and not under the Longshoremen’s Relief Act.

The District Court Should Have Limited Its Decision to a Determination of the Maritime Question. The Assignments of Error on that Argument Are as Follows:

IV.

“The Court erred in finding that Albert V. Steffen, libelant, sustained certain injuries while engaged in the performance of his duties as a watchman on the S. S. Prentiss.”

VII.

“The Court erred in remanding said cause for the sole purpose of fixing the compensation due to libelant, Albert V. Steffen, by respondents, Santa Cruz Oil Company, a corporation, and Associated Indemnity Corporation, a corporation, and each of them.”

VIII.

“The Court erred in directing that additional testimony be taken by the Deputy Commissioner, 13th Compensation District, U. S. Employees Compensation Commission for the sole purpose of fixing the Compensation due to libelant, Albert V. Steffen, in order to determine the amount thereof.”

XI.

“The Court erred in finding that libelant sustained an injury and that at the time of sustaining his injuries libelant was engaged in maritime employment upon navigable waters of the United States.”

XII.

“The Court erred in finding that at the time of sustaining said injuries libelant was engaged in the performance of the duties of such employment.”

XIII.

“The Court erred in finding that the present disability of libelant arose from injuries received in the course of his employment.”

All the above assignments of error question the right of the District Court to do more in its decree than decide the question of whether or not Steffen's employment was maritime in character. The same points are referred to in appellant's statement of points on appeal at page 120 of the Apostles on Appeal as follows:

"4. That the Commissioner did not find that libelant had been injured or that his alleged or claimed injuries were received in the course of his employment.

"5. That since the Commissioner made no finding as to whether libelant had been injured or whether his alleged or claimed injuries were sustained in the course of his employment the Court erred in directing that a hearing be had by the Commissioner on the sole issue of finding the amount of compensation due libelant.

"6. That if said employment of libelant shall be held to be maritime in character it is the duty of the Commission and not of the District Court to determine the fact of injury and whether or not such injury was incurred in the course of the employment." [Apostles on Appeal pages 112 and 113.]

As state in the statement of points on appeal herein:

"3. The power of the District Court was limited to the determination of whether or not the occupation of libelant was maritime in character.

"4. That the Commissioner did not find that libelant had been injured or that his alleged or claimed injuries were received in the course of his employment.

"5. That since the Commissioner made no finding as to whether libelant had been injured or

whether his alleged or claimed injuries were sustained in the course of his employment the Court erred in directing that a hearing be had by the Commissioner on the sole issue of finding the amount of compensation due libelant.

“6. That if said employment of libelant shall be held to be maritime in character it is the duty of the Commission and not of the District Court to determine the fact of injury and whether or not such injury was incurred in the course of the employment.” [Apostles on Appeal page 120.]

The finding of the Deputy Commissioner went no further than to decide on the evidence submitted to him that the employment of Steffen was not maritime in character and, therefore, he could not recover under the provisions of the Longshoremen's and Harbor Worker's Compensation Act. He made no *finding as to whether or not claimant was injured or as to whether or not claimant's injuries were received in the course of his employment*. The District Court in making its decision decreed:

“That this cause be remanded to the Deputy Commissioner, 13th Compensation District, U. S. Employees Compensation Commission for the sole purposes of fixing the compensation due to libelant, Albert V. Steffen, by respondents Santa Cruz Oil Company and Associated Indemnity Corporation, and each of them, and, if necessary to take additional testimony in relation to such compensation in order to determine the amount thereof, and to fix the compensation due attorneys for libelant for services rendered in this proceeding.

“It is further ordered that libelant recover from respondents Santa Cruz Oil Company and Associated Indemnity Corporation his costs herein expended, the same to be taxed by the clerk of this Court.”

In other words, the District Court by its decree made the implied finding that claimant was injured and that he was injured in the course of his employment. This becomes very prejudicial to appellants because it was claimed by them before the Commissioner that Steffen had not been injured; that his physical condition was due to arthritis and chronic ailments and not to any trauma or injuries received during the course of his employment. Those questions we respectfully submit were solely for the determination of the Commissioner. The power of the District Court was limited by the stipulation and by-law to the question of whether or not Steffen's employment was maritime in character and hence whether the provisions of the Longshoremen's and Harbor Worker's Compensation Act applied.

We believe it is well settled that the District Court in a proceeding of this nature cannot make findings of fact for the Commissioner and that if the matter was to be remanded it should have been remanded to the Commissioner for hearing upon the vital questions of whether or not claimant was actually injured and what was the nature and extent of his injuries. Since, therefore, the questions of fact should be determined by the Commissioner there was no power in the District Court to change findings or to make findings for the Commissioner.

Volhn v. Indemnity Insurance Co., 288 U. S. 162;

S. Chicago Coal & Dock Co. v. Bassett, 309 U. S. 251.

The authority to determine facts was confided by Congress to the Deputy Commissioner.

See also:

Williams v. American Employers Ins. Co., 107
Fed (2d) 953. Certiorari denied, 309 U. S.
682;

Crowell v. Benson, 285 U. S. 22.

Conclusion.

We respectfully submit that the decision of the District Court should be reversed and the proceedings dismissed on the ground that the employment of Steffen was not maritime in nature. We further respectfully urge that in any event the decision of the District Court should be modified and that if the case is remanded to the Deputy Commissioner he should be permitted to hear the entire matter on evidence submitted before him and to make his own determination as to whether or not claimant was actually injured and as to whether or not such injuries were received by the claimant in the course of his employment as watchman.

We respectfully urge that the District Court exceeded its authority in attempting to make findings on said matters which were primarily for the determination of the Commissioner, and that the District Court in a proceeding of this nature has no power to find facts for the Commissioner.

The claim, if any, of Steffen comes squarely under the State Compensation Laws of California because his contract contemplated only duties as a watchman upon a vessel which was not being used at any time during his employment and which, in fact, never went to sea after the commencement of his employment and was finally scrapped. There was nothing whatsoever in the character of his duties which contemplated any maritime activity or any service aboard the vessel while it was in use.

Respectfully submitted,

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No. 10361.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

HILLCONE STEAMSHIP COMPANY, a corporation, SANTA
CRUZ OIL COMPANY, a corporation, and ASSOCIATED
INDEMNITY CORPORATION, a corporation,

Appellants,

vs.

ALBERT V. STEFFEN,

Appellee.

APPELLANTS' CLOSING BRIEF.

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MAY 10 1943

TOPICAL INDEX.

	PAGE
The question before the trial court was a legal and not a factual one	1
The Longshoremen's and Harbor Workers' Act was enacted to provide compensation for longshoremen and harbor workers upon navigable waters when state compensation statutes are inapplicable	3
Steffen was not a member of the crew and his claim, if any, is based on contract, not on tort.....	4
Conclusion	6

TABLE OF AUTHORITIES CITED.

	PAGE
Crowell v. Benson, 285 U. S. 22.....	4
Davis v. Department of Labor & Industries of the State of Washington, 87 L. Ed., Adv. Ops. 175.....	5
Grant Smith-Porter Ship Company v. Rhode, 257 U. S. 469.....	5
Moore Drydock Company v. Pillsbury, 100 Fed. (2d) 245.....	5
Seneca Washed Gravel Corporation v. McManigal, 65 Fed. (2d) 779	6
Shipbuilding etc. Co. v. Industrial Accident Commission, 57 Cal. App. 355	5
South Chicago Coal & Dock Co. v. Bassett, 309 U. S. 251, 84 L. Ed. 732.....	3, 4
Union Oil Company v. Pillsbury, 63 Fed. (2d) 925.....	6

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Appellee.

APPELLANTS' CLOSING BRIEF.

The Question Before the Trial Court Was a Legal and
Not a Factual One.

There is no serious dispute between the parties as to the facts herein. A hearing was had before the Deputy Commissioner under the provisions of the Longshoremen's and Harbor Workers' Compensation Act. He decided solely that he had no jurisdiction and refused to hear the proceedings further. Thereafter all the testimony and findings were certified to the trial court and upon that record and the pleadings it was submitted to the Trial Court upon briefs and as a question of law. According to the stipulation of counsel the question of law to be determined by the trial court was "Was the service or

employment of the libelant Albert V. Steffen as watchman on the S. S. Prentiss at the time of his injury maritime in character?"

If the trial court decided that question in the negative, there was an end of the matter. If it was decided in the affirmative, as it was, what was the effect of the decision? It is our contention that such question being decided in the affirmative, the sole power of the court was to send back the proceedings for further hearing before the Commissioner. Upon the questions which were peculiarly within the jurisdiction of the Commissioner, the trial court could not find facts for the Commissioner. The trial court was limited to deciding the question of law presented. The question presented to the trial court was only the legal one, upon which depended jurisdiction of the Commissioner. The court having decided that the Commissioner had jurisdiction under the Longshoremen's Act had no other alternative but to send the case back for determination by him of the basic facts of injury, the nature and extent of injuries and the amount of compensation to which the injured man was entitled, if any. It is not claimed by either party that the Commissioner has passed upon said facts. In truth, he expressly refused to do so and held that he had no jurisdiction. In the absence of any findings of facts by the Commissioner, it seems obvious to us that the trial court could not make findings for the Commissioner, but that the Commissioner should be directed to make his own findings in the manner governed by statute after a hearing before him.

We have in our opening brief cited authorities and discussed this phase of the case on pages 19 to 23, inclusive. We refer to it here because of the opening statement of case in appellee's reply brief.

The Longshoremen's and Harbor Workers' Act Was Enacted to Provide Compensation for Longshoremen and Harbor Workers Upon Navigable Waters When State Compensation Statutes Are Inapplicable.

As an initial proposition appellee states: "The purpose of the Longshoremen's and Harbor Workers' Compensation Act was to provide compensation to all those various sorts of longshoremen and harbor workers who were performing labor on a vessel." In support of such proposition appellee cites the case of *South Chicago Coal & Dock Co. v. Bassett*, 309 U. S. 251, 84 L. Ed. 732, at 736.

Appellee does not quote the entire language of Justice Hughes in setting forth the issues in the cited case. The court says:

"We think it clear that Congress in finally adopting the phrase * * * intended to leave entitled to compensation all those various sorts of longshoremen and harbor workers who were performing labor on a vessel *and to whom state compensation statutes were inapplicable*. The question is whether decedent, in this instance, fell within that class."

In other words, the holding of the court as stressed by our italics was that the statute was applicable to those longshoremen *to whom state compensation statutes were not applicable*.

We have heretofore attempted, in our opening brief, pages 10 to 18, inclusive, to show that the compensation laws of California did apply to Steffen and therefore he had a remedy in California and not one under the Longshoremen's Act. It is not contended by either side here that Steffen was a member of the crew. If he were a

member of the crew, he would be barred from compensation under the provisions of the Longshoremen's Act.

In *Crowell v. Benson*, 285 U. S. 22, also cited by appellee, the court again emphasizes that the Longshoremen's Act is applicable in maritime employment "*if recovery through workmen's compensation proceedings may not validly be provided by state law.*"

Steffen Was Not a Member of the Crew and His Claim, If Any, Is Based on Contract, Not on Tort.

In the *South Chicago* case cited by appellees, the decedent was an employee of the steamship company and was drowned while serving his employer as a laborer aboard the vessel. The case on its facts was a different one and it was properly held that the deceased was in a maritime occupation. In the case at bar it must be kept in mind that Steffen was a watchman at all times on a boat which was not used for maritime purposes at any time during the performance of his services. We again refer to our argument on pages 10 to 18, inclusive, of our opening brief, and respectfully maintain that "In contract matters admiralty jurisdiction depends upon the nature of the transaction and, in matters of tort, the locality." We refer again to the cases cited there by us. We believe that this case is not one within the admiralty jurisdiction of the court and that the action was improperly brought there. We believe that the action should have been in the nature of a writ to compel the Commissioner to take action and assume jurisdiction and that it was not proper to have the questions determined by an admiralty court as an admiralty proceeding *in personam*. No tort is claimed by appellees. Any rights of Steffen arose by reason of contract between Steffen and his em-

ployer to act as a watchman upon this boat which was not at any time during his employment used for maritime services. The fact that the boat was resting upon waters in a dock does not change the law that we have just cited and that has been pronounced repeatedly by the courts of the United States and California in cases such as *Grant Smith-Porter Ship Company v. Rhode*, 257 U. S. 469; in *Shipbuilding etc. Co. v. Industrial Accident Commission*, 57 Cal. App. 355, and other citations set forth in pages 10 to 13, inclusive, of our opening brief.

In the case of *Moore Drydock Company v. Pillsbury*, 100 Fed. (2d) 245, at 246, cited by appellee, the question was "whether decedent Howland at the time of his death was an employee under the act or excepted from the act as a member of a crew of any vessel." The Longshoremen's Act provided that no compensation shall be payable in respect of the disability or death of "a master *or a member of a crew of any vessel*." Howland was properly held in that case not to be a member of the crew. The question of whether or not he should have received compensation under the Workmen's Compensation Act of California was not raised. The boat was in use and went about San Francisco Bay and on inland waterways as far as Stockton. Decedent had been employed for several years as a rigger and aboard a launch for repairing boats. The facts and the questions of law in said case are entirely different from those in the case at bar.

Appellee's argument that since the injuries occurred on the navigable waters of the United States, it was not compensable under any state workers' compensation act is refuted by the recent decision of *Davis v. Department of Labor & Industries of the State of Washington*, 87 L. Ed., Adv. Ops. 175, which case is referred to by both parties herein.

Another case relied upon by appellee is the case of *Union Oil Company v. Pillsbury*, 63 Fed. (2d) 925. In that case the injured man was third officer and a member of the crew. He had no outside contract at the time of his injury. That case seems to us to hold that where a member of the crew is engaged in outside duties he may come within the provisions of the act. Those facts were entirely different from a case where an outsider who is not a seaman or a member of the crew, such as Steffen, who is hired to perform duties which are not maritime in character and where his injuries do not arise from tort of the employers and where he is primarily within the provisions of the State Act for the benefit of employees. The holding in the *Union Oil* case was on the question as to whether or not the injured man was a member of the crew. Nobody here claims that Steffen was a member of the crew of the *Prentiss*. If he were, he would be out under the provisions of the act. So in the case of *Seneca Washed Gravel Corporation v. McManigal*, 65 Fed. (2d) 779, the question determined was whether or not the deceased was a member of the crew and it was held that he was not.

Conclusion.

For convenience we have referred at times to Steffen as the injured man. It is not conceded that he ever was injured in the course of his employment. The Commissioner never determined that fact and it was the contention before him that Steffen's condition was due to natural causes and not to any injury. The trial court could not determine that matter. It was solely for the Commissioner if he had jurisdiction at all. If he had jurisdiction, which we do not concede, he should be directed to

proceed with the case and make his findings on the issues of fact before him, which includes the question of injury. The trial court can not do that for him in a proceeding such as this where the sole question presented was one of law. Steffen was never engaged in a maritime occupation. The vessel was at all times out of use. The fact that it was in the water did not under the ruling of the cited cases change the law that one whose duties were not maritime in character and where the obligation arose entirely from contract and not from tort, should proceed under the State Laws enacted for his benefit and not under the Federal Longshoremen's Act before the Commissioner. Admiralty jurisdiction was not present here. We respectfully submit that the decision of the trial court should be reversed.

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No. 10361.

IN THE

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Appellee.

APPELLANTS' SUPPLEMENTAL BRIEF.

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FILED

JUN - 7 1943

TABLE OF AUTHORITIES CITED.

CASES.	PAGE
Kobilkin v. Pillsbury, C. C. A., Cal., 1939, 103 F. (2d) 667, certiorari granted, 1940, 60 S. Ct. 97, 308 U. S. 530, 84 L. Ed. 447, affirmed, 1940, 60 S. Ct. 465, 309 U. S. 619, 84 L. Ed. 983, rehearing denied, 1940, 60 S. Ct. 584, 309, U. S. 695, 84 L. Ed. 1035.....	3
Twin Harbor Stevedoring & Tug Company v. Marshall, 103 F. (2d) 513.....	3

STATUTES.	
Longshoremen's and Harbor Workers Act, Sec. 921.....	1
Longshoremen's and Harbor Workers Act, Sec. 921, para. (b)	4

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APPELLANTS' SUPPLEMENTAL BRIEF.

At the time of the oral argument the Court directed that citations be furnished in connection with the jurisdictional question as to the right of claimant, Steffen, to proceed in the form of action which he had instituted in the District Court. Section 921 of the Longshoremen's and Harbor Workers Act provides an exclusive method whereby the proceedings of the commissioner may be reviewed. Said section reads as follows:

“Review of Compensation Orders. (a) A compensation order shall become effective when filed in the office of the deputy commissioner as provided in section 919 of this chapter, and, unless proceedings

for the suspension or setting aside of such order are instituted as provided in subdivision (b) of this section, shall become final at the expiration of the thirtieth day thereafter.

(b) If not in accordance with law, a compensation order may be suspended or set aside, in whole or in part, through injunction proceedings, mandatory or otherwise, brought by any party in interest against the deputy commissioner making the order, and instituted in the Federal district court for the judicial district in which the injury occurred (or in the district court of the United States for the District of Columbia if the injury occurred in this District). The orders, writs, and processes of the court in such proceedings may run, be served, and be returnable anywhere in the United States. The payment of the amounts required by an award shall not be stayed pending final decision in any such proceeding unless upon application for an interlocutory injunction the court, on hearing, after not less than three days' notice to the parties in interest and the deputy commissioner, allows the stay of such payments, in whole or in part, where irreparable damage would otherwise ensue to the employer. The order of the court allowing any such stay shall contain a specific finding, based upon evidence submitted to the court and identified by reference thereto, that such irreparable damage would result to the employer, and specifying the nature of the damage.

(c) If any employer or his officers or agents fails to comply with a compensation order making an award, that has become final, any beneficiary of such award or the deputy commissioner making the order, may apply for the enforcement of the order to the Federal district court for the judicial district in which

the injury occurred (or to the district court of the United States for the District of Columbia if the injury occurred in the District). If the court determines that the order was made and served in accordance with law, and that such employer or his officers or agents have failed to comply therewith, the court shall enforce obedience to the order by writ of injunction or by other proper process, mandatory or otherwise, to enjoin upon such person and his officers and agents compliance with the order.

(d) Proceedings for suspending, setting aside, or enforcing a compensation order, whether rejecting a claim or making an award, shall not be instituted otherwise than as provided in this section and section 918 of this chapter. Mar. 4, 1927, c. 509, §21, 44 Stat. 1436, as amended June 25, 1936, c. 804, 49 Stat. 1921."

A special method is therefore set up by Congress in the act itself for the review of orders such as the one in the case at bar. It has been held by this court that the proceedings contemplated by the act are on the admiralty side of the court. See *Kobilkin v. Pillsbury*, C. C. A., Cal., 1939, 103 F. (2d) 667, certiorari granted, 1940, 60 S. Ct. 97, 308 U. S. 530, 84 L. Ed. 447, affirmed, 1940, 60 S. Ct. 465, 309 U. S. 619, 84 L. Ed. 983, rehearing denied, 1940, 60 S. Ct. 584, 309, U. S. 695, 84 L. Ed. 1035. See also *Twin Harbor Stevedoring & Tug Company v. Marshall*, 103 F. (2d) 513.

The two cases just cited were both decided by the United States Circuit Court of Appeals for the Ninth Circuit.

In the case at bar the action in the District Court after the hearing by the commissioner was commenced on the

admiralty side of the court as it should have been. Our contention is that the procedure followed was not that prescribed by the act, namely, the filing of a petition to obtain a mandatory injunction compelling the commissioner to proceed with the hearing as is set forth in paragraph (b) of said section 921. Petitioner does not ask for a mandatory injunction for that purpose unless it might be held that the general allegations of the prayer be so interpreted. As we view the so-called libel and complaint of Steffen, it constitutes a petition to the District Court to find the facts and weigh the testimony, and is not a proceeding asking for a mandatory injunction as required by the act.

Respectfully submitted,

S. S. TIPTON,

A. G. RITTER,

Attorneys for Appellants.

United States
Circuit Court of Appeals

For the Ninth Circuit.

MOHAWK PETROLEUM COMPANY, a California corporation, EDWIN V. McKENZIE, as Executor of the Estate of Alfred L. Marsten, deceased, EDWIN V. McKENZIE, ALFRED L. MARSTEN, JR., and LEWIS A. MARSTEN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of the Record

Upon Petition to Review Decisions of the Tax Court
of the United States

FILED

MAR 19 1943

No. 10373

United States
Circuit Court of Appeals

For the Ninth Circuit.

MOHAWK PETROLEUM COMPANY, a California corporation, EDWIN V. McKENZIE, as Executor of the Estate of Alfred L. Marsten, deceased, EDWIN V. McKENZIE, ALFRED L. MARSTEN, JR., and LEWIS A. MARSTEN,

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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

Page

Answer:

#105967	31
#105968	34
#105969	38
#105970	42
#105971	46

Appearances:

#105967	1
#105968	3
#105969	4
#105970	5
#105971	6

Certificate of Clerk	106
----------------------------	-----

Decision:

#105967	84
#105968	85
#105969	86
#105970	87
#105971	88

Index	Page
Designation of Record (CCA)	108
Docket Entries:	
#105967	1
#105968	3
#105969	4
#105970	5
#105971	6
Opinion (All Causes)	67
Petition for Redetermination of Deficiency	
(#105967)	7
Exhibit A—Notice of Deficiency	13
#105968	33
#105969	37
#105970	41
#105971	45
Petition for Review and Assignments of Error	
(All Causes)	90
Notice of Filing	102
Praecipe	104
Notice of Filing	105
Statement of Points and Designation of Record (CCA)	108

Index Page

Stipulation Designating Portions of the Record to be Printed (CCA)	110
Stipulation of Facts (#105967)	49
Exhibit A — Statement of Red Ribbon Ranch Lease—Analysis of Net Capital- ized Cost of Well Equipment Subject to Depreciation, etc.	59
Transcript of Hearing (All Causes)	63

APPEARANCES

For Taxpayer:

FRED H. BROWN, C.P.A.

R. KEMP SLAUGHTER, ESQ.,

For Comm'r.:

T. M. MATHER, ESQ.

Docket No. 105967

MOHAWK PETROLEUM COMPANY,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1940

Dec. 24—Petition received and filed. Taxpayer notified. Fee paid.

“ 26—Copy of petition served on General Counsel.

1941

Jan. 28—Answer filed by General Counsel.

1941

Jan.28—Request for hearing in San Francisco filed by General Counsel.

“ 31—Notice issued placing proceeding on San Francisco, Cal. calendar. Service of answer and request made.

1942

Feb. 25—Hearing set March 23, 1942 at San Francisco, Calif.

Mar. 25—Hearing had before Mr. Arnold on merits. Submitted. Motion to consolidate dockets 105967, 68, 69, 70 and 71 granted. Stipulation of facts filed. Briefs due May 9, 1942—replies June 9, 1942.

Apr. 4—Transcript of hearing of 3/25/42 filed.

May 7—Brief filed by taxpayer.

“ 9—Brief filed by General Counsel.

“ 11—Copy of brief served on General Counsel.

Jun. 9—Reply brief filed by taxpayer. 6/9/42 copy served.

Oct. 30—Opinion rendered, Arnold, Div. 12. Decision will be entered for the respondent. 11/3/42 copy served.

Nov. 4—Decision entered, Arnold. Div. 12.

1943

Jan.29—Supersedeas bond in the amount of \$33,000. 190.50 approved and ordered filed.

“ 29—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error filed by taxpayer.

“ 29—Proof of service filed by taxpayer.

1943

- Jan. 29—Praecipe for record filed by taxpayer.
- “ 29—Notice of filing praecipe for record with
proof of service thereon, filed by taxpayer.
Agreed to.
- Feb. 6—Notice of appearance of R. Kemp Slaughter
as counsel for taxpayer filed. [1*]
-

APPEARANCES

For Taxpayer:

FRED H. BROWN, C.P.A.

R. KEMP SLAUGHTER, ESQ.,

For Comm'r.:

T. M. MATHER, ESQ.

Docket No. 105968

ALFRED L. MARSTEN, Jr.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

(Printer's Note: Docket Entries are the same as
listed in Docket No. 105967.) [2]

*Page numbering appearing at top of page of original certified
Transcript of Record.

APPEARANCES

For Taxpayer:

FRED H. BROWN, C.P.A.

R. KEMP SLAUGHTER, ESQ.,

For Comm'r.:

T. M. MATHER, ESQ.

Docket No. 105969

LEWIS A. MARSTEN,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

(Printer's Note: Docket Entries are the same as listed in Docket No. 105967.) [3]

APPEARANCES

For Taxpayer:

FRED H. BROWN, C.P.A.

R. KEMP SLAUGHTER, ESQ.,

For Comm'r.:

T. M. MATHER, ESQ.

Docket No. 105970

EDWIN V. McKENZIE,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

(Printer's Note: Docket Entries are the same as listed in Docket No. 105967.) [4]

APPEARANCES

For Taxpayer:

FRED H. BROWN, C.P.A.

R. KEMP SLAUGHTER, ESQ.,

For Comm'r.:

T. M. MATHER, ESQ.

Docket No. 105971

ESTATE OF ALFRED L. MARSTEN, Dec'd.

EDWIN V. McKENZIE, Executor,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

(Printer's Note: Docket Entries are the same as listed in Docket No. 105967.) [5]

United States Board of Tax Appeals

Docket No. 105967

MOHAWK PETROLEUM COMPANY,
Petitioner,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols—San Francisco Division IRA:90-D DCE C:TS:PD SF:CCG) dated October 4, 1940 and as a basis of its proceeding alleges as follows:

(1) The petitioner is a corporation duly organized and existing under and by virtue of the laws of the State of California and its address is 405 Montgomery Street, San Francisco, California. The returns for the period here involved were filed with the Collector of United States Internal Revenue for the First District of California.

(2) The notice of deficiency (a copy of which is attached marked Exhibit A) was mailed to the petitioner on October 4, 1940.

(3) The taxes in controversy are income taxes for the fiscal years ended September 30, 1936 and Sep-

tember 30, 1937. The deficiencies asserted are \$991.84 for the fiscal year ended September [6] 30, 1936 and \$15,603.44 for the fiscal year ended September 30, 1937, making a total of \$16,595.28 of which amount approximately \$900.00 for the fiscal year ended September 30, 1936 and \$9,000.00 for the fiscal year ended September 30, 1937 or a total of \$9,900.00 is in controversy.

(4) The determination of tax set forth in the said notice of deficiency was based on the following errors:

(a) In determining the taxable net income of the petitioner for the fiscal year ended September 30, 1936 the Commissioner erroneously disallowed a deduction of \$5,044.13 representing a claimed loss on the abandonment of physical equipment consequent to the abandonment of an oil well located on property leased by the petitioner.

(b) The Commissioner similarly erroneously disallowed losses claimed on the abandonment of similar physical equipment during the year ended September 30, 1937 in amount of \$35,026.52.

(5) The facts upon which the petitioner relies as the basis of its proceeding are as follows:

(a) It was the petitioner's consistent practice from the time it was organized in 1928 to charge intangible development costs in connection with the drilling of oil wells to expense. The tangible development costs for physical equipment used in connection with the drilling of oil wells such as casing, pipe, oil rig, pumping equipment, etc., were capi-

talized in its accounts. The tangible equipment costs for each separate well was separately set up in its records.

During the fiscal year ended September 30, 1936, petitioner abandoned its Red Ribbon Ranch Lease Well No. 6. The loss [7] attributable to the abandonment of this well was computed in its accounts and claimed in its tax returns as follows:

Total cost of tangible equipment capitalized (Well completed during fiscal year ended Sept. 30. 1930)				\$9,093.60
Less depreciation previously written off.....				4,049.47
Year Ended	Bbls. Produced	Unit Rate	Amount	
Sept. 30-30	12,421	,032668392	405.77	
" "-31	22,876	"	747.32	
" "-32	41,285	,032971291	1,361.22	
" "-33	37,847	,032920749	1,245.95	
" "-34	8,785	"	289.21	
" "-35				
" "-36				
Total			4,049.47	
Loss				<u>5,044.13</u>

During the fiscal year ended September 30, 1937, petitioner abandoned its McKeehan Lease Wells No. 1 and No. 3 and its Earl Fruit Company Lease Well No. 1. The losses attributable to the abandonment of the said wells were computed in its accounts and claimed in its tax returns as follows:

McKeehan Well No. 1

Total cost of tangible equipment capitalized (Well completed during fiscal year ended September 30, 1934)	22,304.17
Less depreciation previously written off.....	14,909.37

Year Ended	Bbls. Produced	Unit Rate	Amount
Sept. 30-34	105,426	.043556776	4,592.02
" " -35	114,161	.063458951	7,244.54
" " -36	40,122	"	2,546.10
" " -37	8,300	"	526.71
Total			14,909.37

Loss	7,394.80
------------	----------

[8]

Earl Fruit Well No. 1

Total cost of tangible equipment capitalized (Well completed during fiscal year ended September 30, 1936)	\$15,735.91
Less salvage value of tangible equipment removed from well	2,204.92
Loss	13,530.99

McKeehan Well No. 3

Total cost of tangible equipment capitalized (Well completed during fiscal year ended September 30, 1935)	16,542.36
Less salvage value of tangible equipment removed from well	1,479.75
Balance of equipment abandoned.....	15,062.61
Less depreciation previously written off.....	961.88

Year Ended	Bbls. Produced	Unit Rate	Amount
Sept. 30-35	9,218	.063458951	584.96
" " -36	5,938	"	376.92
" " -37			
			961.88

Loss	14,100.73
------------	-----------

The petitioner consistently computed its depreciation on tangible well equipment on the so-called unit of production method. That is to say, the annual depreciation on each separate lease was determined by dividing the potential production in barrels of that lease into the total equipment cost of that lease. The rate per barrel thus arrived at was then multiplied by the number of barrels produced each year to determine the depreciation applicable to each lease. In all cases where there was more than one well on a given lease no separate depreciation account for each well was maintained in the taxpayer's accounts but the production of each well was [9] separately kept so that it was possible to determine at any time the depreciation previously written off for any particular well by multiplying the production of the well by the unit depreciation rate.

The Commissioner has erroneously held that the claimed losses were not deductible in the years during which the said wells were abandoned, but that the undepreciated cost of the said tangible well equipment should be recovered over the life of the remaining wells located on the said leases on the so-called "unit of production" method.

Wherefore, the petitioner prays that this Board may hear the proceeding and determine that the deficiency due from the petitioner for the fiscal year ended September 30, 1936 should not be in excess of approximately \$100.00 and the deficiency for

the year ended September 30, 1937 should not be in excess of approximately \$6,600.00.

Counsel for Petitioner

(Signed)

FRED H. BROWN

465 California Street

San Francisco, California

Counsel:

LESTER HERRICK and HERRICK

465 California Street

San Francisco, California [10]

JURAT

State of California,

City and County of San Francisco—ss.

Alfred L. Marsten, Jr., being first duly sworn, deposes and says that he is President of Mohawk Petroleum Company, the petitioner above named; that he has authority to verify the foregoing petition; that he has read the same or has had it read to him and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be on information and belief, and those he believes to be true.

(Signed)

ALFRED L. MARSTEN, JR.

Subscribed and sworn to before me this 19th day of December, 1940.

(Signed) KATHRYN E. STONE

Notary Public in and for the City and County of San Francisco, State of California.

My commission expires March 1, 1941 [11]

EXHIBIT "A"

Form 1231

SN-IT-2

TREASURY DEPARTMENT

Internal Revenue Service
433 Federal Office Building
San Francisco, California

Oct. 4, 1940

Office of
Internal Revenue
Agent in Charge
San Francisco Division
IRA:90-D

DCE
(C:TS:PD
SF:CCG)

Mohawk Petroleum Company,
405 Montgomery Street,
San Francisco, California.

Gentlemen:

You are advised that the determination of your income tax liability for the taxable year(s) 1936, 1937 and 1938, discloses a deficiency of \$16,595.28 for the taxable year(s) 1936 and 1937 and an over-

Exhibit "A"—(Continued)

assessment of \$5,660.87 for the taxable year(s) 1938 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, San Francisco, California for the attention of —Conference Section— The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,

Commissioner,

By (Signed) F. M. HARLESS,

Internal Revenue Agent in
Charge

Enclosures:

Statement.

Form of waiver and acceptance. [12]

Exhibit "A"—(Continued)

STATEMENT

San Francisco
 IRA:90-D
 DCE
 (C:TS:PD
 SF:CCG)

Mohawk Petroleum Company,
 405 Montgomery Street,
 San Francisco, California.

TAX LIABILITY FOR THE TAXABLE YEARS ENDED SEPTEMBER 30, 1936,
 SEPTEMBER 30, 1937 AND SEPTEMBER 30, 1938

Income Tax	Liability	Assessed	Overassessment	Deficiency
Fiscal Years ended:				
September 30, 1936.....	\$ 73,428.21	\$ 72,436.37		\$ 991.84
September 30, 1937.....	59,695.95	44,092.51		15,603.44
September 30, 1938.....	68,241.43	73,902.30	\$5,660.87	
	<u>\$201,365.59</u>	<u>\$190,431.18</u>	<u>\$5,660.87</u>	<u>\$16,595.28</u>

Exhibit "A"—(Continued)

In making this determination of your income tax liability, careful consideration has been given to your protest dated May 22, 1940; to the statements made at the conferences held on June 18, 1940 and August 22, 1940 and to your claim for refund filed on September 23, 1939.

It is noted that your claim for refund, covering the fiscal year ended September 30, 1936, is based upon the decision of the United States Circuit Court of Appeals in the case of Wilshire Oil Co. Inc. v. Commissioner, 95 Fed. (2d) 971. Inasmuch as the decision of the Circuit Court of Appeals was reversed by the United States Supreme Court, 308 U. S. 90, 60 S. Ct. 18, the claim for refund will be disallowed and official notice will be issued by registered mail in accordance with section 3772 (a) (2) of the Internal Revenue Code.

The overassessment shown herein will be made the subject of a certificate of overassessment which will reach you in due course through the office of the collector of internal revenue for your district, and will be applied by that official in accordance with section 322 of the Revenue Act of 1936, provided that you fully protect yourself against the running of the statute of limitations with respect to the apparent overassessment referred to in this letter, by filing with the collector of internal revenue for your district, a claim for refund on form 843, a copy of which is enclosed, the basis of which may be as set forth herein. [13]

Exhibit "A"—(Continued)

A copy of this letter and statement has been mailed to your representatives, Lester Herrick and Herrick, 465 California Street, San Francisco, California, in accordance with the authority contained in the power of attorney executed by you and on file in this office.

ADJUSTMENTS TO NET INCOME

Fiscal Year Ended September 30, 1936

Net income as disclosed by return.....		\$512,264.48
Unallowable deductions and additional income		
(a) Depreciation	\$23,866.65	
(b) Losses	5,044.13	
(c) Capital stock tax.....	8,979.00	37,889.78
	<hr/>	<hr/>
Total		550,154.26
Nontaxable income and additional deductions		
(d) Depletion	13,913.90	
(e) Bad Debts recovered.....	2,216.99	16,130.89
	<hr/>	<hr/>
Net income adjusted.....		534,023.37
		<hr/> <hr/>
		[14]

EXPLANATION OF ADJUSTMENTS

(a) In your return depreciation of equipment on the basis of production in relation to the oil reserve was claimed in the amount of \$257,358.94. The deduction claimed is adjusted as follows:

Exhibit "A"—(Continued)

	Allowed	Deducted	Decrease
Well equipment	\$132,115.49	153,676.88	21,561.39
General field equipment:			
Miscellaneous	72,702.16	77,679.07	4,976.91
Weedpatch absorp-			
tion plant	22,890.74	24,661.96	1,771.22
Weedpatch gas line..	5,783.90	1,341.03	(4,442.87)
	<u>233,492.29</u>	<u>257,358.94</u>	<u>23,866.65</u>

(b) On your return you claimed the deduction of \$5,044.13 in the fiscal year ended September 30, 1936 (and \$35,026.52 in the fiscal year ended September 30, 1937) as a loss sustained through the abandonment of oil well equipment at oil wells shut down during the taxable year although other wells on the same leaseholds continued to operate.

You elected and have continued to deduct depreciation on your oil well equipment on your income tax returns on a unit of production basis based upon the total estimated production of oil to be obtained from an entire leasehold.

Since your tangible oil well equipment installations on each leasehold in question consist of more than one installation and depreciation has been based upon the average lives of all such installations, losses claimed on the normal retirements of such assets are not allowable inasmuch as an average rate contemplates a normal retirement of assets both before and after the average life has been reached and there is therefore, no possibility of ascertaining any actual loss under such circumstances

Exhibit "A"—(Continued)

until all assets contained in the group have been retired or disposed of.

Therefore the losses claimed in the respective years are disallowed as deductions. See Article 23 (e)-3, Regulations 94 and 101. [15]

(c) The deduction on your return for capital stock tax in the amount of \$18,513.00 is adjusted as follows:

Original declared value of capital stock as disclosed by your capital stock tax return for the fiscal year ended June 30, 1936.....	\$9,000,000.00
Add: Net income for fiscal year ended September 30, 1936.....	534,023.37
	<hr/>
Adjusted declared value.....	9,534,023.37
	<hr/>
Capital stock tax at \$1.00 per \$1,000.00 of value	9,534.00
Deduction in return.....	18,513.00
	<hr/>
Excessive deduction disallowed.....	8,979.00
	<hr/>

(d) The deduction in your return for depletion is increased as follows: [16]

Exhibit "A"—(Continued)

	50 Percent of Net Income	27½ Percent of Gross Income	Cost Depletion	Allowable Depletion
Fruitvale Field				
Red Ribbon	\$ 13,774.38	16,256.70	152.34	13,774.38
Doherty	1,447.78	1,726.56		1,447.78
Fishback	8,136.37	9,507.93		8,136.37
Ward	5,355.08	5,643.24		5,355.08
Osborne	None	1,185.32		None
Bowman	None	1,209.32		None
Kern County Land	None	1,015.36	154.06	154.06
Weedpatch Field				
Hood	86,218.86	129,994.31		86,218.86
Clendenen	131,996.99	144,278.82		131,996.99
McKeehan	16,029.40	14,841.64		14,841.64
Bloemer	29,551.62	33,001.31		29,551.62
Mabry	2,703.50	2,341.17	98.49	2,341.17
De Reynier	15,392.67	14,705.86	375.56	14,705.86
Earl Fruit Company	None	925.03		None
Manners Royalty	311.62	171.39		171.39
<hr/>				
Total depletion allowable				308,695.20
Depletion deducted				294,781.30
<hr/>				
Additional deduction allowed				13,913.90
<hr/>				

Exhibit "A"—(Continued)

(e) The account of C. F. Frederickson & Son amounting to \$2,216.99 was charged off your books and claimed as a bad debt deduction in your return for the fiscal year ended September 30, 1935. The deduction thereof has been previously disallowed. The account was collected in December 1935 and credited to Miscellaneous Income. The deduction in your 1935 return having been previously disallowed, this amount is eliminated from income. [17]

COMPUTATION OF TAX

Fiscal Year Ended September 30, 1936

Income Tax

Taxable net income.....	\$534,023.37
Income tax at $13\frac{3}{4}$ percent.....	73,428.21
Income tax assessed:	
Original list, Account No. 400017—	
First California District.....	70,436.37
Additional May 24, 1940 list—	
Account No. 529002—	
First California District.....	2,000.00
Total assessed	72,436.37
Deficiency of income tax.....	991.84

Exhibit "A"—(Continued)

ADJUSTMENTS TO NET INCOME

Fiscal Year Ended September 30, 1937

Net income as disclosed by line 27, page 2 of your return.....		109,045.17
Unallowable deductions and additional income		
(a) Depletion	58,242.11	
(b) Depreciation	19,717.13	
(c) Equipment losses	35,026.52	
(d) Loss—Weedpatch absorption plant	1,041.72	
(e) Capital gain	11,693.23	
(f) Capital stock tax.....	3,622.00	129,342.71
	<hr/>	<hr/>
Net income adjusted.....		238,387.88
		<hr/> <hr/>

[18]

EXPLANATION OF ADJUSTMENTS

(a) The deduction in your return for depletion is adjusted as follows:

Exhibit "A"—(Continued)

	50 percent of Net Income	27½ percent of Gross Income	Cost Depletion	Depletion Allowable
Fruitvale Field:				
Red Ribbon	\$6,046.18	14,711.72		6,046.18
Doherty	857.20	1,327.99		857.20
Fishback	2,973.73	6,128.34		2,973.73
Ward	2,128.95	3,316.95		2,128.95
Osborn	2,519.27	7,786.77		2,519.27
Bowman	462.83	2,246.64		462.83
Kern County Land.....	None	8,624.15	1,308.41	1,308.41
Weedpatch Field:				
Hood	3,778.67	43,342.71		3,778.67
Clendenen	15,831.67	64,703.42		15,831.67
McKeehan	5,963.11	7,480.64		5,963.11
Bloemer	20,756.86	23,122.24		20,756.86
Mabry	None	580.04		None
De Reynier	7,299.90	11,384.33		7,299.90
Earl Fruit Co.....	None	9,504.76		None
Manners Royalty	255.88	140.73		140.73
<hr/>				
Total depletion allowable.....				70,067.51
Deduction claimed in your return.....				128,309.62
<hr/>				
Excessive deduction disallowed.....				58,242.11

Exhibit "A"—(Continued)

(b) In your return depreciation of equipment on the basis of production in relation to the oil reserve was claimed in the amount of \$257,358.94. The deduction claimed is adjusted as follows: [19]

	Allowed	Deducted	Decrease
Well equipment	\$ 84,140.35	103,722.52	19,582.17
General field equipment:			
Miscellaneous	52,436.13	56,605.08	4,168.95
Weedpatch absorp-			
tion plant	9,776.32	6,983.22	(2,793.10)
Weedpatch gas line..	2,470.17	1,229.28	(1,240.89)
 Total	<u>148,822.97</u>	<u>168,540.10</u>	<u>19,717.13</u>

(c) See adjustment (b) for 1936.

(d) The loss claimed in your return on account of abandonment of the Weedpatch absorption plant is adjusted as follows:

Total cost of plant.....	85,339.86
Less: Depreciation sustained.....	52,101.74
 Net cost at abandonment.....	<u>33,238.12</u>
Less salvage	1,500.00
 Net loss	<u>31,738.12</u>
Loss deducted	32,779.84
 Excessive deduction disallowed.....	<u>1,041.72</u>

(e) In your return you claimed a loss of \$3,076.96 on the sale of Weedpatch gas lines to Lomita Gasoline Company whereas it has been determined that you realized a proffit of \$8,616.27. Adjustment therefor is accordingly made as follows:

Exhibit "A"—(Continued)

Amount received from sale.....	16,000.00
Cost	22,831.48
Less: Depreciation sustained.....	15,447.75
	<hr/>
Net cost at date of sale.....	7,383.73
	<hr/>
Profit realized	8,616.27
Loss reported	3,076.96
	<hr/>
Total adjustment	11,693.23
	<hr/> <hr/>
	[20]

(f) The deduction on your return for accrued capital stock tax is adjusted to the amount actually paid for the fiscal year ended June 30, 1938 as follows:

Deduction for accrued capital stock tax.....	\$9,622.00
Actual payment in 1938.....	6,000.00
	<hr/>
Difference restored to income.....	3,622.00
	<hr/> <hr/>

COMPUTATION OF TAX

Fiscal Year Ended September 30, 1937

Income Tax:

Normal Tax:

Taxable net income.....	238,387.88
Less: Dividends received credit, for companies other than mutual investment companies (85 percent of dividends received from taxable domestic corporations).....	2,885.75
	<hr/>
Normal tax net income.....	235,502.13
8 percent of \$ 2,000.00 (over 0 to \$ 2,000)	160.00
11 percent of \$ 13,000.00 (over \$ 2,000 to \$15,000)	1,430.00
13 percent of \$ 25,000.00 (over \$15,000 to \$40,000)	3,250.00
15 percent of \$195,502.13 (over \$40,000).....	29,325.32
	<hr/>
Total normal tax.....	34,165.32
	<hr/> <hr/>

[21]

Exhibit "A"—(Continued)

Surtax on Undistributed Profits:	
Taxable net income.....	\$238,387.88
Less: Normal Tax.....	34,165.32
<hr/>	
Adjusted net income.....	204,222.56
Less: Dividends paid credit.....	60,500.00
<hr/>	
Undistributed net income.....	143,722.56
<hr/>	
7 percent of \$20,422.26.....	1,429.56
12 percent of \$20,422.26.....	2,450.67
17 percent of \$40,844.51.....	6,943.57
22 percent of \$40,844.51.....	8,985.79
27 percent of \$21,189.02.....	5,721.04
<hr/>	
Total surtax	25,530.63
Normal tax	34,165.32
<hr/>	
Total income tax (normal tax and surtax).....	59,695.95
Income tax assessed (normal tax and surtax):	
Original list, account No. 400011—	
First California District.....	19,092.51
Additional list, account No. 529003—	
May 1940—First California	
District	25,000.00
<hr/>	
Deficiency of income tax.....	15,603.44
<hr/>	

[22]

ADJUSTMENTS TO NET INCOME

Fiscal Year Ended September 30, 1938

Net income as disclosed by line 28,	
page 2 of your return.....	\$507,623.32
Unallowable deductions and	
additional income	
(a) Depletion	23,301.97
(b) Depreciation	8,048.09
(c) Abandonment losses	37,864.73
(d) Administrative expense	27,500.00
<hr/>	
Total	604,338.11

Exhibit "A"—(Continued)

Nontaxable income and additional deductions	
(e) Capital gain	134,453.89
<hr/>	
Net income adjusted.....	469,884.22
<hr/>	
<hr/>	
[23]	

EXPLANATION OF ADJUSTMENTS

(a) The deduction in your return for depletion is adjusted as follows:

Exhibit "A"—(Continued)

	50 percent of net Income	27½ percent of Gross Income	Cost Depletion	Depletion Allowable
Fruitvale Field				
Red Ribbon	\$ None	5,688.89		None
Doherty	None	399.31		None
Fishback	None	1,452.43		None
Ward	42.23	973.03		42.23
Osborne	None	2,189.83		None
Bowman	None	336.58		None
Kern County Land.....	None	817.25	124.01	124.01
Weedpatch Field				
Hood	14,390.14	15,069.25		14,390.14
Clendenen	17,929.75	17,948.53		17,929.75
McKeehan	1,900.69	1,920.10		1,900.69
Bloemer	4,674.97	4,972.26		4,674.97
De Reynier	2,485.67	3,045.90		2,485.67
Earl Fruit Company.....	301.44	8,493.18		301.44
Manners Royalty	87.15	47.93		47.93
Total depletion allowable.....				41,896.83
Deduction claimed in your return.....				65,198.80
Excessive deduction disallowed.....				23,301.97

Exhibit "A"—(Continued)

(b) In your return depreciation of equipment on the basis of production in relation to the oil reserve was deducted in the amount of \$51,872.67. The deduction claimed is adjusted as follows:

	Allowed	Deducted	Decrease
Well equipment	28,227.24	32,381.89	4,154.65
General field equipment	15,597.34	19,490.78	3,893.44
Total	<u>43,824.58</u>	<u>51,872.67</u>	<u>8,048.09</u>
			[24]

(c) Equipment losses claimed in your return on account of the abandonment of certain wells are disallowed as a deduction for reasons explained in adjustment (b) for 1936.

(d) Payments of \$13,750.00 each made to your president, A. L. Marsten, Jr., and your vice-president, Lewis A. Marsten, in the guise of bonuses are held to be a distribution of income. The deduction thereof in your return is accordingly disallowed.

(e) In your return you reported a taxable profit of \$313,011.50 from the sale of your plant and equipment. The profit reported is reduced by the sum of \$134,453.89 representing adjustments made to plant and equipment accounts for the fiscal years 1936, 1937 and 1938 as follows:

1936

Excessive depreciation disallowed.....	\$23,866.65	
Less: Amount restored on your books		
by credit to surplus.....	7,848.31	16,018.34
Red Ribbon Well #6—Abandonment loss		
disallowed		5,044.13

Exhibit "A"—(Continued)

1937

Excessive depreciation disallowed.....	19,717.13
Abandonment losses disallowed:	
McKeehan Well #3.....	14,100.73
McKeehan Well #1.....	7,394.80
Earl Fruit Well #1.....	13,530.99
Absorption plant (excessive loss claimed)....	1,041.72
Excessive cost deducted — Weedpatch gas lines sale	11,693.23

1938

Excessive depreciation disallowed.....	8,048.09
Abandonment losses disallowed:	
Kern County Land Co. Well #4.....	4,127.38
Hood Well #4.....	7,429.80
Hood Well #3.....	8,005.97
Hood Well #9.....	18,301.58
 Total adjustment	 134,453.89

[25]

COMPUTATION OF TAX

Fiscal Year Ended September 30, 1938

Income Tax:

Normal Tax:

Taxable net income.....	\$469,884.22
Less: Dividends received credit, for companies other than mutual investment companies (85 percent of dividends received from tax- able domestic corporations).....	7,208.00
 Normal Tax net income.....	 462,676.22
 8 percent of \$ 2,000.00 (over \$ 0 to \$ 2,000)	160.00
11 percent of \$ 13,000.00 (over \$ 2,000 to \$15,000)	1,430.00
13 percent of \$ 25,000.00 (over \$15,000 to \$40,000)	3,250.00
15 percent of \$422,676.22 (over \$40,000).....	63,401.43
 Total normal tax.....	 68,241.43
Surtax on Undistributed Profits:	
Taxable net income.....	469,884.22

Exhibit "A"—(Continued)

Less: Normal tax.....	68,241.43
Adjusted net income.....	401,642.79
Less: Dividends paid credit.....	816,877.94
Undistributed net income.....	None
Total income tax.....	68,241.43
Income tax assessed	
Original list, account No. 400004—	
First California District.....	73,902.30
Overassessment of income tax.....	5,660.87

[Endorsed]: U.S.B.T.A. Filed Dec. 24, 1940.
[26]

[Title of Board and Cause.]

Docket No. 105967

ANSWER .

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above named petitioner, admits and denies as follows:

- (1). Admits the allegations contained in paragraph (1) of the petition.
- (2). Admits the allegations contained in paragraph (2) of the petition.
- (3). Admits that the taxes in controversy are income taxes for the fiscal years ended September 30,

1936 and September 30, 1937; that the deficiencies asserted are \$991.84 for the fiscal year ended September 30, 1936 and \$15,603.44 for the fiscal year ended September 30, 1937, making a total of \$16,595.28; denies the remaining allegations contained in paragraph (3) of the petition. [27]

(4) (a) and (b). Denies that the Commissioner erred in the determination of the deficiency as alleged in subparagraphs (a) and (b) of paragraph (4) of the petition.

(5) (a). Admits the first paragraph contained in subparagraph (a) of paragraph (5) of the petition, and that the petitioner consistently computed its depreciation on tangible well equipment on the so-called unit of production method, that in all cases where there was more than one well on a given lease no separate depreciation account for each well was maintained in the taxpayer's accounts, but denies the remaining allegations contained in said paragraph.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

(Signed) J. P. WENCHEL

T.M.M.

Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD,

Division Counsel;

T. M. MATHER,

Special Attorney,

Bureau of Internal Revenue.

[Endorsed]: U.S.B.T.A. Filed Jan. 28, 1941.

[28]

United States Board of Tax Appeals

Docket No. 105968

ALFRED L. MARSTEN, JR.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

(1) The petitioner is an individual and resides in the City and County of San Francisco, State of California. His business address is 405 Montgomery Street, San Francisco, California. The returns for the periods here involved were filed with the Collector of United States Internal Revenue for the First District of California. [29]

(5) The facts upon which the petitioner relies as the basis for his proceeding are as follows:

(a) The petitioner was the owner of 3,600 shares

of stock of Mohawk Petroleum Company. The said company distributed all of its assets to its stockholders prior to October 4, 1940. The petitioner received a portion of the assets of the said Mohawk Petroleum Company as a liquidating dividend. The respondent asserts and petitioner admits that he is a transferee of the assets of the said Mohawk Petroleum Company.

[Endorsed]: U. S. B. T. A. Filed Dec. 24, 1940. [30]

[Title of Board and Cause.]

Docket No. 105968

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above-named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to petition filed by the above-named petitioner, admits, denies, and alleges as follows:

(1). Admits the allegations contained in paragraph (1) of the petition.

(2). Admits the allegations contained in paragraph (2) of the petition.

(3). Admits that the taxes in controversy are income taxes for the fiscal years ended September 30, 1936 and September 30, 1937, that the deficiencies asserted are \$991.84 for the fiscal year ended September 30, 1936 and \$15,603.44 for the fiscal year ended September 30, 1937, but denies

the remaining allegations contained in paragraph (3) of the petition. [49]

(4) (a) and (b). Denies that the Commissioner erred in the determination of the deficiencies as alleged in subparagraphs (a) and (b) of paragraph (4) of the petition.

(5) (a). Admits the allegations contained in subparagraph (a) of paragraph (5) of the petition.

(5) (b). Admits the first paragraph contained in subparagraph (b) of paragraph (5) of the petition, and that the company consistently computed its depreciation on tangible well equipment on the so-called unit of production method; that in all cases where there was more than one well on a given lease no separate depreciation account for each well was maintained in the taxpayer's accounts; for lack of information, denies the remaining allegations contained in said paragraph.

(6). Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

(7). Further answering, respondent alleges as follows:

1. Mohawk Petroleum Company has heretofore dissolved and distributed its assets to its stockholders, including this petitioner, who assumed all its liabilities, including any liability for Federal income tax.

2. The assets so transferred to petitioner had a value in excess of the Federal tax liability of Mohawk Petroleum [50] Company, for the taxable years ended September 30, 1936, and September 30,

1937, involved in this proceeding, together with interest thereon as provided by law.

3. Mohawk Petroleum Company is now, and ever since its dissolution has been, insolvent and without assets out of which its income tax liability, together with interest thereon as provided by law, can be satisfied, and no part of said liability has ever been paid.

4. The petitioner as transferee, and by reason of the facts herein alleged, is liable for the payment of the amount of the deficiencies here involved, together with interest as provided by law.

Wherefore, it is prayed that the petitioner's appeal be denied, and that the Commissioner's determination be approved, and that petitioner be held liable at law and in equity as transferee of the Mohawk Petroleum Company for a deficiency for the taxable year ended September 30, 1936, in the amount of \$991.84, and for the taxable year ended September 30, 1937, in the amount of \$15,603.44, together with interest thereon as provided by law.

J. P. WENCHEL,

T.M.M.

Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD,

Division Counsel;

T. M. MATHER,

Special Attorney,

Bureau of Internal Revenue.

[Endorsed]: U. S. B. T. A. Filed Jan. 24, 1941. [51]

United States Board of Tax Appeals

Docket No. 105969

LEWIS A. MARSTEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

(1) The petitioner is an individual and resides in the City and County of San Francisco, State of California. His business address is 405 Montgomery Street, San Francisco, California. The returns for the periods here involved were filed with the Collector of United States Internal Revenue for the First District of California. [52]

(5) The facts upon which the petitioner relies as the basis for his proceeding are as follows:

(a) The petitioner was the owner of 3,600 shares of stock of Mohawk Petroleum Company. The said company distributed all of its assets to its stockholders prior to October 4, 1940. The petitioner received a portion of the assets of the said Mohawk Petroleum Company as a liquidating dividend. The respondent asserts and petitioner admits that he is a transferee of the assets of the said Mohawk Petroleum Company.

[Endorsed]: U. S. B. T. A. Filed Dec. 24, 1940. [53]

[Title of Board and Cause.]

Docket No. 105969

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits, denies, and alleges as follows:

(1) Admits the allegations contained in paragraph (1) of the petition.

(2) Admits the allegations contained in paragraph (2) of the petition.

(3) Admits that the taxes in controversy are income taxes for the fiscal years ended September 30, 1936 and September 30, 1937, that the deficiencies asserted are \$991.84 for the fiscal year ended September 30, 1936 and \$15,603.44 for the fiscal year ended September 30, 1937, but denies the remaining allegations contained in paragraph (3) of the petition. [73]

(4) (a) and (b) Denies that the Commissioner erred in the determination of the deficiencies as alleged in subparagraphs (a) and (b) of paragraph (4) of the petition.

(5) (a) Admits the allegations contained in subparagraph (a) of paragraph (5) of the petition.

(5) (b) Admits the first paragraph contained in subparagraph (b) of paragraph (5) of the petition, and that the company consistently computed

its depreciation on tangible well equipment on the so-called unit of production method; that in all cases where there was more than one well on a given lease no separate depreciation account for each well was maintained in the taxpayer's accounts; for lack of information, denies the remaining allegations contained in said paragraph.

(6) Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

(7) Further answering, respondent alleges as follows:

1. Mohawk Petroleum Company has heretofore dissolved and distributed its assets to its stockholders, including this petitioner, who assumed all its liabilities, including any liability for Federal income tax.

2. The assets so transferred to petitioner had a value in excess of the Federal tax liability of Mohawk Petroleum Company, for the taxable years ended September 30, 1936, and [74] September 30, 1937, involved in this proceeding, together with interest thereon as provided by law.

3. Mohawk Petroleum Company is now, and ever since its dissolution has been, insolvent and without assets out of which its income tax liability, together with interest thereon as provided by law, can be satisfied, and no part of said liability has ever been paid.

4. The petitioner as transferee, and by reason of the facts herein alleged, is liable for the payment

of the amount of the deficiencies here involved, together with interest as provided by law.

Wherefore, it is prayed that the petitioner's appeal be denied, and that the Commissioner's determination be approved, and that petitioner be held liable at law and in equity as transferee of the Mohawk Petroleum Company for a deficiency for the taxable year ended September 30, 1936, in the amount of \$991.84, and for the taxable year ended September 30, 1937, in the amount of \$15,603.44, together with interest thereon as provided by law.

(Signed) J. P. WENCHEL,

T.M.M.

Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD,

Division Counsel;

T. M. MATHER,

Special Attorney,

Bureau of Internal Revenue.

[Endorsed]: U. S. B. T. A. Filed Jan. 28, 1941. [75]

United States Board of Tax Appeals

Docket No. 105970

EDWIN V. McKENZIE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION

(1) The petitioner is an individual and resides in the City and County of San Francisco, State of California. His business address is 1049 Mills Building, San Francisco, California. The returns for the periods here involved were filed with the Collector of United States Internal Revenue for the First District of California. [76]

(5) The facts upon which the petitioner relies as the basis for his proceeding are as follows:

(a) The petitioner was the owner of 1,000 shares of stock of Mohawk Petroleum Company. The said company distributed all of its assets to its stockholders prior to October 4, 1940. The petitioner received a portion of the assets of the said Mohawk Petroleum Company as a liquidating dividend. The respondent asserts and petitioner admits that he is a transferee of the assets of the said Mohawk Petroleum Company.

[Endorsed]: U. S. B. T. A. Filed Dec. 24, 1940. [77]

[Title of Board and Cause.]

Docket No. 105970

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits, denies, and alleges as follows:

(1). Admits the allegations contained in paragraph (1) of the petition.

(2). Admits the allegations contained in paragraph (2) of the petition.

(3). Admits that the taxes in controversy are income taxes for the fiscal years ended September 30, 1936 and September 30, 1937, that the deficiencies asserted are \$991.84 for the fiscal year ended September 30, 1936 and \$15,603.44 for the fiscal year ended September 30, 1937, but denies the remaining allegations contained in paragraph (3) of the petition. [96]

(4) (a) and (b). Denies that the Commissioner erred in the determination of the deficiencies as alleged in subparagraphs (a) and (b) of paragraph (4) of the petition.

(5) (a). Admits the allegations contained in subparagraph (a) of paragraph (5) of the petition.

(5) (b). Admits the first paragraph contained in subparagraph (b) of paragraph (5) of the petition, and that the company consistently computed its de-

preciation on tangible well equipment on the so-called unit of production method; that in all cases where there was more than one well on a given lease no separate depreciation account for each well was maintained in the taxpayer's accounts; for lack of information, denies the remaining allegations contained in said paragraph.

(6). Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

(7). Further answering, respondent alleges as follows:

1. Mohawk Petroleum Company has heretofore dissolved and distributed its assets to its stockholders, including this petitioner, who assumed all its liabilities, including any liability for Federal income tax.

2. The assets so transferred to petitioner had a value in excess of the Federal tax liability of Mohawk Petroleum Company, for the taxable years ended September 30, 1936, and [97] September 30, 1937, involved in this proceeding, together with interest thereon as provided by law.

3. Mohawk Petroleum Company is now, and ever since its dissolution has been, insolvent and without assets out of which its income tax liability, together with interest thereon as provided by law, can be satisfied, and no part of said liability has ever been paid.

4. The petitioner as transferee, and by reason of the facts herein alleged, is liable for the pay-

ment of the amount of the deficiencies here involved, together with interest as provided by law.

Wherefore, it is prayed that the petitioner's appeal be denied, and that the Commissioner's determination be approved, and that petitioner be held liable at law and in equity as transferee of the Mohawk Petroleum Company for a deficiency for the taxable year ended September 30, 1936, in the amount of \$991.84, and for the taxable year ended September 30, 1937, in the amount of \$15,603.44, together with interest thereon as provided by law.

(Signed) J. P. WENCHEL,

T.M.M.

Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

ALVA C. BAIRD,

Division Counsel;

T. M. MATHER,

Special Attorney,

Bureau of Internal Revenue.

[Endorsed]: U. S. B. T. A. Filed Jan. 28, 1941.

[98]

United States Board of Tax Appeals

Docket No. 105971

ESTATE OF ALFRED L. MARSTEN, Deceased,
EDWIN V. McKENZIE, Executor
Petitioner

vs.

COMMISSIONER OF INTERNAL REVENUE
Respondent

PETITION

(1) The petitioner is Edwin V. McKenzie as Executor of the Estate of Alfred L. Marsten, Deceased, and his address is 1049 Mills Building, San Francisco, California. The returns for the periods here involved were filed with the Collector of United States Internal Revenue for the First District of California. [99]

(5) The facts upon which the petitioner relies as the basis for his proceeding are as follows:

(a) The petitioner was the owner of 52,300 shares of stock of Mohawk Petroleum Company. The said company distributed all of its assets to its stockholders prior to October 4, 1940. The petitioner received a portion of the assets of the said Mohawk Petroleum Company as a liquidating dividend. The respondent asserts and petitioner admits that he is a transferee of the assets of the said Mohawk Petroleum Company.

[Endorsed]: U. S. B. T. A. Filed Dec. 24, 1940.

[100]

[Title of Board and Cause.]

Docket No. 105971

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits, denies, and alleges as follows:

(1). Admits the allegations contined in paragraph (1) of the petition.

(2). Admits the allegations contained in paragraph (2) of the petition.

(3). Admits that the taxes in controversy are income taxes for the fiscal years ended September 30, 1936 and September 30, 1937, that the deficiencies asserted are \$991.84 for the fiscal year ended September 30, 1936 and \$15,603.44 for the fiscal year ended September 30, 1937, but denies the remaining allegations contained in paragraph (3) of the petition. [120]

(4) (a) and (b). Denies that the Commissioner erred in the determination of the deficiencies as alleged in subparagraphs (a) and (b) of paragraph (4) of the petition.

(5) (a). Admits the allegations contained in sub-subparagraph (b) of paragraph (5) of the petition,

(5) (b). Admits the first paragraph contained in paragraph (a) of paragraph (5) of the petition. and that the company consistently computed its de-

preciation on tangible well equipment on the so-called unit of production method; that in all cases where there was more than one well on a given lease no separate depreciation account for each well was maintained in the taxpayer's accounts; for lack of information, denies the remaining allegations contained in said paragraph.

(6). Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

(7). Further answering, respondent alleges as follows:

1. Mohawk Petroleum Company has heretofore dissolved and distributed its assets to its stockholders, including this petitioner, who assumed all its liabilities, including any liability for Federal income tax.

2. The assets so transferred to petitioner had a value in excess of the Federal tax liability of Mohawk Petroleum Company, for the taxable years ended September 30, 1936, and [121] September 30, 1937, involved in this proceeding, together with interest thereon as provided by law.

3. Mohawk Petroleum Company is now, and ever since its dissolution has been insolvent and without assets out of which its income tax liability, together with interest thereon as provided by law, can be satisfied, and no part of said liability has ever been paid.

4. The petitioner as transferee, and by reason of the facts herein alleged, is liable for the payment

of the amount of the deficiencies here involved, together with interest as provided by law.

Wherefore, it is prayed that the petitioner's appeal be denied, and that the Commissioner's determination be approved, and the petitioner be held liable at law and in equity as transferee of the Mohawk Petroleum Company for a deficiency for the taxable year ended September 30, 1936, in the amount of \$991.84, and for the taxable year ended September 30, 1937, in the amount of \$15,603.44, together with interest thereon as provided by law.

(Signed) J. P. WENCHEL

T.M.M.

Chief Counsel,

Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD,

Division Counsel;

T. M. MATHER,

Special Attorney,

Bureau of Internal Revenue.

[Endorsed]: Filed Jan. 28, 1941. [122]

United States Board of Tax Appeals

Docket No. 105967

MOHAWK PETROLEUM COMPANY

Petitioner

vs.

COMMISSIONER OF INTERNAL REVENUE

Respondent

STIPULATION OF FACTS

It is hereby mutually stipulated and agreed by and between the parties hereto that the facts in respect to this matter are as follows:

The petitioner, Mohawk Petroleum Company, acquired certain oil and gas leases upon lands in the Fruitvale Oil Field in Kern County, California, shortly after its organization in 1928. One of the leases so acquired was called the Red Ribbon Ranch Lease. At the time of the acquisition of this lease there was a producing oil well located thereon. Five additional wells were drilled on the said Red Ribbon Ranch Lease by petitioner in 1929, 1930 and 1931 and all of the five wells became producing oil wells.

The petitioner has consistently closed its books and filed its income tax returns on the basis of a fiscal year ending September 30. All of the six wells located on the Red Ribbon Ranch Lease continued to produce crude oil until during the fiscal year ended September 30, 1934, when one well became

nonproductive. This well, petitioner's Red Ribbon Ranch Lease Well No. 6, was finally abandoned in the fiscal year ended September 30, 1936. The other five wells located on the said Red Ribbon Ranch Lease continued to produce crude oil for several years after the year ended September 30, 1936. [123]

On December 12, 1932, the petitioner entered into an oil and gas lease with E. B. and Frona McKeehan covering certain lands in the Weedpatch Oil Field in Kern County, California. During the fiscal year ended September 30, 1934, two producing oil wells were drilled on the said McKeehan Lease and during the fiscal year ended September 30, 1935, one producing oil well was drilled on the said lease. During the fiscal year ended September 30, 1937, Wells No. 1 and No. 3 on the said McKeehan Lease became nonproductive and were abandoned. Well No. 2 on the said lease continued to produce for several years after the fiscal year ended September 30, 1937.

On March 17, 1936, the petitioner entered into an oil and gas lease with Earl Fruit Company, a corporation, covering certain lands in Kern County, California. During the fiscal year ended September 30, 1936, one oil well was completed on the said Earl Fruit Company Lease and during the fiscal year ended September 30, 1937, two additional wells were completed on the said lease. Earl Fruit Company Lease Well No. 1 started production of crude oil in August 1936 and became nonproductive in May of 1937 and was abandoned prior to Septem-

ber 30, 1937. Well No. 2 on the said Earl Fruit Company Lease was completed in January 1937 but was not a commercially productive well and was abandoned shortly after completion and the capitalized cost of the said well was written off as a dry hole loss and allowed as such by the respondent in the fiscal year ended September 30, 1937. Earl Fruit Company Lease Well No. 3 was completed in March 1937 and produced crude oil for several years after its completion. Two additional producing wells were later completed on this lease. [124]

Ever since its organization in 1928, petitioner has consistently deducted intangible development costs in connection with drilling oil wells as expense and has capitalized the cost of tangible oil well equipment. The cost so capitalized of each separate well was set up separately in the petitioner's books. The cost so capitalized applicable to the wells here in question is as follows:

Red Ribbon Ranch Lease Well No. 6.....	\$ 9,093.60
McKeehan Lease Well No. 1.....	22,304.17
McKeehan Lease Well No. 3.....	16,542.36
Earl Fruit Company Lease Well No. 1.....	15,735.91

Ever since its organization in 1928, petitioner has consistently computed depreciation on the capitalized cost of its oil wells on the so-called unit of production method. That is to say, the annual depreciation applicable to the capitalized cost of the wells located on a particular lease was determined by dividing the capitalized cost (after a 10% reduction for estimated salvage value) of all the wells

on a particular lease by the estimated net potential crude oil production of the lease and the unit cost per barrel thus determined was then multiplied by the net number of barrels produced during the year from that particular lease to arrive at the amount of depreciation for the year. Exhibit "A" attached hereto and made a part hereof is a statement of the petitioner's Red Ribbon Ranch Lease in analysis of the net capitalized cost of well equipment subject to depreciation, depreciation thereon, estimated total potential production, annual production, etc., by years from the year ended September 30, 1929 to September 30, 1936, inclusive, in illustration of the method used in determining the annual depreciation of oil well equipment. The same basic method was used in determining depreciation of oil well equipment with respect to petitioner's McKeehan Lease, hereinbefore referred to, and to depreciation of [125] oil well equipment with respect to all other producing oil leases owned by petitioner.

The depreciation reserve account in the petitioner's general ledger relating to depreciation on the capitalized cost of its oil wells is segregated between the depreciation applicable to each separate oil lease but is not segregated as between each separate oil well located on a particular lease.

Ever since its organization in 1928, petitioner has maintained a record of the crude oil production of each separate oil well.

During the fiscal year ended September 30, 1936,

petitioner wrote off as a loss consequent to the abandonment of its Red Ribbon Well No. 6 in that year an amount of \$5,044.13, which said amount was computed as follows:

Total cost of tangible equipment capitalized.....	\$9,093.60
Less depreciation previously written off.....	4,049.47

Year ended	Net Bbls. Produced after Royalty to Lessor— Red Ribbon Well No. 6	Unit Deprecn. Rate applicable to Red Ribbon Ranch Lease Well Equipment	Amount
Sept. 30, 1930	12,421	\$.032668392	405.77
Sept. 30, 1931	22,876	.032668392	747.32
Sept. 30, 1932	41,285	.032971291	1,361.22
Sept. 30, 1933	37,847	.032920749	1,245.95
Sept. 30, 1934	8,785	.032920749	289.21
Sept. 30, 1935	None	.	None
Sept. 30, 1936	None		None
Total			4,049.47
Abandonment Loss			5,044.13

During the fiscal year ended September 30, 1937, petitioner wrote off as losses consequent to the abandonment of its McKeehan Wells No. 1 and No. 3 and its Earl Fruit Company Well No. 1 a total amount of \$35,026.52, which amount was computed as follows: [126]

Loss on McKeehan Well No. 1

Total cost of tangible equipment capitalized.....	\$22,304.17
Less depreciation previously written off.....	14,909.37

Year ended	Net Bbls. Produced after Royalty to Lessor— McKeehan Well No. 1	Unit Deprecn. Rate applicable to McKeehan Lease Well Equipment	Amount
Sept. 30, 1934	105,426	\$.043556776	4,592.02
Sept. 30, 1935	114,161	.063458951	7,244.54
Sept. 30, 1936	40,122	.063458951	2,546.10
Sept. 30, 1937	8,300	.063458951	526.71
Total			14,909.37

Loss on McKeehan Well No. 1.....	7,394.80
----------------------------------	----------

Loss on McKeehan Well No. 3

Total cost of tangible equipment capitalized.....	16,542.36
Less salvage value of tangible equipment removed from well	1,479.75

Balance of equipment abandoned.....	15,062.61
Less depreciation previously written off.....	961.88

Year ended	Net Bbls. Produced after Royalty to Lessor— McKeehan Well No. 3	Unit Deprecn. Rate applicable to McKeehan Lease Well Equipment	Amount
Sept. 30, 1935	9,218	\$.063458951	584.96
Sept. 30, 1936	5,938	.063458951	376.92
Sept. 30, 1937	None		—
Total			961.88

Loss on McKeehan Well No. 3.....	14,100.73
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Loss on Earl Fruit Company Well No. 1

Total cost of tangible equipment capitalized.....	15,735.91
Less salvage value of tangible equipment removed from well	2,204.92

Balance	13,530.99
Depreciation previously written off.....	None

Petitioner did not adjust the cost of well equipment on account of depreciation in its computation of loss on the abandonment of Earl Fruit Company Lease Well No. 1 because at the time of closing its books for the fiscal year ended September 30, 1936 it had no reliable engineering reports as to the possible potential crude oil production from this lease and accordingly had insufficient data to compute depreciation with respect to the said lease for the said year and did not compute any depreciation in its books nor claim any depreciation in its income tax return with respect to the said lease for the said year. Respondent computed and allowed depreciation applicable to the well equipment located on said Earl Fruit Company Lease for the year ended September 30, 1936 as follows:

	Total Cost of Tangible Eqpt.	Less estimated Salvage 10%	Balance subject to Deprecn.	*Unit Cost (Per Bbl.)	Net Production after Royalty to Lessor	Deprecn.
Well No. 1	\$15,735.91	1,573.59	14,162.32		2,884.00	
Well No. 2	4,003.29	400.33	3,602.96		None	
Total	19,739.20	1,973.92	17,765.28	.1188687	2,884.00	342.82

*Based on total net potential production (after deduction of royalty to lessor) of 149,453 barrels of crude oil.

In his final determination of tax for the fiscal year ended September 30, 1936, the respondent disallowed the claimed deduction of \$5,044.13 consequent to the abandonment of petitioner's Red Ribbon Ranch Lease Well No. 6 and similarly disallowed during the fiscal year ended September 30, 1937 claimed deductions totaling \$35,026.52 consequent to the abandonment of petitioner's McKeehan Lease Wells No. 1 and No. 3 and Earl Fruit Company Lease Well No. 1 for the following reason: [128]

“(b) On your return you claimed the deduction of \$5,044.13 in the fiscal year ended September 30, 1936 (and \$35,026.52 in the fiscal year ended September 30, 1937) as a loss sustained through the abandonment of oil well equipment at oil wells shut down during the taxable year although other wells on the same leaseholds continued to operate.

You elected and have continued to deduct depreciation on your oil well equipment on your income tax returns on a unit of production basis based upon the total estimated production of oil to be obtained from an entire leasehold.

Since your tangible oil well equipment installations on each leasehold in question consist of more than one installation and depreciation has been based upon the average lives of all such installations, losses claimed on the normal retirements of such assets are not allowable inasmuch as an average rate contemplates a normal retirement of assets both before and after the average life has been reached and

there is therefore, no possibility of ascertaining any actual loss under such circumstances until all assets contained in the group have been retired or disposed of.

Therefore the losses claimed in the respective years are disallowed as deductions. See Article 23 (e)-3, Regulations 94 and 101."

FRED H. BROWN

For Petitioner

J. P. WENCHEL, JR.

For Respondent. [129]

RED RIBBON RANCH LEASE
EXHIBIT "A"

	A	B	C	D	E	F
	Capitalized Cost of Oil Well Eqt., after 10% reduction for salvage (all wells combined)	Deprecn. (E X F)	Net Balance (A minus B)	Estimated Oil Reserves (Barrels) (c)	Production (c)	Unit Cost (per Barrel) See Note (a)
Year ended 9-30-29	\$105,589.73	3,878.04	101,711.69	3,487.881	128,101	\$.030273317
Year ended 9-30-30	8,046.92	7,837.18	209.74		239,901	.032668392
Balance 10- 1-30	113,636.65	11,715.22	101,921.43	3,119,879	368,002	
Year ended 9-30-31		8,246.32	(8,246.32)		252,425	.032668392
Balance 10- 1-31	113,636.65	19,961.54	93,675.11	2,867.454	620,427	
Year ended 9-30-32	868.55	7,059.85	(6,191.30)		214,121	.032971291
Balance 10- 1-32	114,505.20	27,021.39	87,483.81	2,653.333	834,548	
Year ended 9-30-33	(134.10)	6,181.56	(6,315.66)		187,771	.032920749
Balance 10- 1-33	114,371.10	33,202.95	81,168.15	2,465,562	1,022,319	
Year ended 9-30-34	—	3,726.50	(3,726.50)		113,196	.032920749
Balance 10- 1-34	114,371.10	36,929.45	77,441.65	2,352,366	1,135,515	
Year ended 9-30-35	—	2,579.51	(2,579.51)		78,355	.032920749
Balance 10- 1-35	114,371.10	39,508.96	74,862.14	2,274,011	1,213,870	

Year ended 9-30-36)				
Well No. 6)				
Abandoned)	(b) (8,184.24)	2,600.92	(10,785.16)	88,703
	<u>106,186.86</u>	<u>42,109.88</u>	<u>64,076.98</u>	<u>1,302,573</u>
Less depreciation on				
Well No. 6 abandoned	<u>4,049.47</u>			
Balance 10- 1-36	<u>106,186.86</u>	<u>38,060.41</u>	<u>68,126.45</u>	<u>1,302,573</u>

Notes: (a) Unit cost per barrel for depreciation units is determined by dividing the undepreciated balance at the end of a given year for the property as a whole (before any depreciation for that year) by the total oil reserves for that year before eliminating the production for the year but including additions to or reductions from the oil reserves during the year for changes in estimated production. Estimated oil reserves and resulting unit cost per barrel are for the entire lease and the estimate is based upon the aggregate potential production of all wells and no separate determination of unit cost as to each separate well has been made.

(b) Original Cost 9,093.60
 Less 10% for estimated salvage value 909.36

Amount included for depreciation..... 8,184.24

(c) Net barrels after deduction of lessor's royalty interest.

[Endorsed]: U. S. B. T. A. Filed Mar. 25, 1942. [130]

Before the United States Board of Tax Appeals

Docket No. 105967

MOHAWK PETROLEUM COMPANY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent,

Docket No. 105968

ALFRED L. MARSTEN, JR.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 105969

LEWIS A. MARSTEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 105970

EDWIN V. McKENZIE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent. [132]

Docket No. 105971

ESTATE OF ALFRED L. MARSTEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

San Francisco, California,

March 25, 1942,

2:00 P.M.

Met pursuant to notice.

Before:

Hon, William W. Arnold,
Member.

Appearances:

Fred H. Brown, Esq.,
465 California Street,
San Francisco, California,
appearing for the Petitioners.

T. M. Mather, Esq.,
appearing for the Commissioner of Internal
Revenue,
Respondent. [133]

PROCEEDINGS

The Clerk: At the request of Mr. T. M. Mather we will take up Docket 105967, Mohawk Petroleum Company. He has a stipulation of facts to be presented in this proceeding.

Mr. Fred H. Brown, C.P.A., 465 California Street, San Francisco, California, appears for the Petitioners.

STATEMENT ON BEHALF OF RESPONDENT

Mr. Mather: If your Honor please, in this case, as well as the transferee cases that are associated with it, with respect to the transferor, Mohawk Petroleum Company, the parties have entered into a stipulation of facts.

The case presents one issue, that is, whether or not the Petitioner is entitled to abandonment losses on oil well equipment, being on the unit of production basis for depreciation, and the wells that were abandoned being part of the tract.

All the facts with respect to that issue have been stipulated. We ask the stipulation be submitted and that the Board fix the time for filing briefs in the case.

If briefs are filed within 45 days they are to be filed concurrently. That is agreeable to the parties, I understand.

The Member: The depreciation has been on a par unit valuation?

Mr. Mather: It is on the unit of production basis [135] for depreciation. Depreciation is the only issue involved. No depletion is involved.

The Member: That is on the equipment?

Mr. Mather: Oil equipment.

Now in the transferee cases, in the petition in those cases the petition admits transferee liability, and I understand from counsel that if any deficiency is determined in the transferor case that the transferees admit liability for the amount of that addi-

tional deficiency together with interest as provided by law?

Is that correct?

Mr. Brown: That is correct.

The Member: Are these separate transferee cases?

Mr. Mather: Yes. The transferee cases are Alfred L. Marsten, Jr., Docket No. 105968; Lewis A. Marsten, 105969; Edwin V. McKenzie, 105970; and the Estate of Alfred L. Marsten, 105971.

The Member: Should the cases be consolidated?

Mr. Mather: I think probably so.

Mr. Brown: Yes.

The Member: Very well. The cases will be consolidated for briefing and report.

Your stipulation of facts covers all the cases?

Mr. Mather: No. The stipulation of facts only pertains to the transferor, the Mohawk Petroleum Company. [136] But if there is any deficiency determined against the transferor, Mohawk Petroleum Company, then these Petitioners, as transferees, admit their liability for the amount of that deficiency, together with interest as provided by law.

The Member: That is covered by your stipulation?

Mr. Mather: That is an oral stipulation. It is not included in the transferor's stipulation.

Mr. Brown: That is correct.

The Member: You speak for the Petitioners?

Mr. Brown: I speak for the Petitioners; yes, sir.

The Member: And the amount, if there is a deficiency, the full amount of the deficiency is assessable against each transferee?

Mr. Mather: That is correct, your Honor. There will be no question, as I understand it, about the payment of the tax if a deficiency is determined in the Mohawk Petroleum Company case. That tax will be paid. But these people who are the transferees, they have admitted that transferee liability in each of the petitions filed by the various transferees.

The Member: There is no question as to the amount received by them as being sufficient to cover it?

Mr. Brown: There is no question about that.

The Member: I want to get this straight. Very well, gentlemen. It will be so understood. [137]

The Clerk: Simultaneous briefs on May 9th.

The Member: Simultaneous briefs, gentlemen?

Mr. Brown: Yes.

Mr. Mather: Satisfactory.

The Member: Briefs to be filed concurrently on or before May 9th. Reply briefs on or before——

The Clerk: Thirty days—June 9th.

The Member: ——June 9th. Is that satisfactory, gentlemen?

Mr. Mather: Yes.

Mr. Brown: Yes.

The Member: Very well.

(Whereupon, at 2:10 P.M. hearing closed.)

[138]

United States Board of Tax Appeals

MOHAWK PETROLEUM COMPANY,

Petitioner, et al.¹

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket Nos. 105967, 105968, 105969, 105970, 105971

Promulgated October 30, 1942.

Petitioner, having consistently taken depreciation on oil well equipment on the unit of production method based on the estimated oil reserve of a lease and the cost of all equipment thereon, in the absence of a sale or showing of unusual conditions justifying earlier retirement, held not entitled to take a retirement loss on equipment used in connection with an abandoned well on the lease while the lease is producing from other wells located thereon.

Fred H. Brown, C. P. A., for the petitioners.

T. M. Mather, Esq., for the respondent.

OPINION

Arnold: These consolidated proceedings involve

¹Proceedings of the following petitioners are consolidated herewith: Alfred L. Marsten, Jr.; Lewis A. Marsten; Edwin V. McKenzie; and Estate of Alfred L. Marsten, Deceased, Edwin V. McKenzie, Executor.

deficiencies in income taxes determined by the respondent against petitioner Mohawk Petroleum Co. for the fiscal years ended September 30, 1936 and 1937, in the amounts of \$991.84 and \$15,603.44, respectively.

The petitioners in Docket Nos. 105968, 105969, 105970, and 105971 are admittedly transferees of the assets of the Mohawk Petroleum Co. and liable, as such transferees, for any deficiencies determined against the Mohawk Petroleum Co. herein, together with interest thereon as provided by law.

The question involved is whether the Mohawk Petroleum Co., hereinafter referred to as petitioner, is entitled to loss deductions in the amounts of \$5,044.13 and \$35,026.52 claimed to have been sustained by it through the abandonment of oil well equipment in the fiscal years ended September 30, 1936, and September 30, 1937, respectively.

The facts were stipulated.

The petitioner was in the taxable years a California corporation and filed its returns with the collector of internal revenue for the first district of California. The petitioner has consistently closed its books and filed its income tax returns on the basis of a fiscal year ending September 30.

[139]

The petitioner acquired certain oil and gas leases upon lands in the Fruitvale Oil Field in Kern County, California, shortly after its organization in 1928. One of the leases so acquired was called the Red Ribbon Ranch lease. At the time of the acquisition of this lease there was a producing oil

well located thereon. Five additional wells were drilled on the Red Ribbon Ranch lease by petitioner in 1929, 1930, and 1931 and all of the five wells became producing wells. All of the six wells located on the Red Ribbon Ranch lease continued to produce crude oil until during the fiscal year ended September 30, 1934, when one well became nonproductive. This well, petitioner's Red Ribbon Ranch lease well No. 6, was finally abandoned in the fiscal year ended September 30, 1936. The other five wells located on the Red Ribbon Ranch lease continued to produce crude oil for several years after the year ended September 30, 1936.

On December 12, 1932, the petitioner entered into an oil and gas lease with E. B. and Frona McKeehan covering certain lands in the Weedpatch Oil Field in Kern County, California. During the fiscal year ended September 30, 1934, two producing oil wells were drilled on the McKeehan lease and during the fiscal year ended September 30, 1936, one producing oil well was drilled thereon. During the fiscal year ended September 30, 1937, wells Nos. 1 and 3 on the McKeehan lease became nonproductive and were abandoned. Well No. 2 on such lease continued to produce for several years after the fiscal year ended September 30, 1937.

On March 17, 1936, the petitioner entered into an oil and gas lease with the Earl Fruit Co., a corporation, covering certain lands in Kern County, California. During the fiscal year ended September 30, 1936, one oil well was completed on the Earl Fruit

Co. lease and during the fiscal year ended September 30, 1937, two additional wells were completed on that lease. Earl Fruit Co. lease well No. 1 started production of crude oil in August 1936 and become nonproductive in May 1937 and was abandoned prior to September 30, 1937. Well No. 2 on the Earl Fruit Co. lease was completed in January 1937, but it was not a commercially productive well and was abandoned shortly after completion and the capitalized cost of the well was written off as a dry hole loss and allowed as such by the respondent in the fiscal year ended September 30, 1937. Earl Fruit Co. lease well No. 3 was completed in March 1937 and produced crude oil for several years after its completion. Two additional producing wells were later completed on this lease.

Ever since its organization in 1928 petitioner has consistently deducted intangible development costs in connection with drilling oil wells as expense and has capitalized the cost of tangible oil well equipment. The cost so capitalized of each well was set up separately in the petitioner's books. The cost so capitalized applicable to the wells here in question is as follows:

Red Ribbon Ranch Lease Well No. 6.....	\$ 9,093.60
McKeehan Lease Well No. 1.....	22,304.17
McKeehan Lease Well No. 3.....	16,542.36
Earl Fruit Company Lease Well No. 1.....	15,735.91

Ever since its organization in 1928 petitioner has consistently computed depreciation on the so-called unit of production method, that is to say, the an-

nual depreciation applicable to the capitalized cost of oil well equipment located on a particular lease was determined by dividing the capitalized cost (after a 10 per cent reduction for estimated salvage value) of all the wells on a particular lease by the estimated net potential crude oil production of the lease and the unit cost per barrel thus determined was then multiplied by the net number of barrels produced during the year from that particular lease to arrive at the amount of depreciation for the year. Estimated oil reserves and resulting unit cost per barrel were for an entire lease and the estimate was based upon the aggregate potential production of all wells and no separate determination of unit cost as to each separate well was made.

The depreciation reserve account in the petitioner's general ledger relating to depreciation on the capitalized cost of its oil wells is segregated as between the depreciation applicable to each separate oil lease, but is not segregated as between each separate oil well located on a particular lease.

Ever since its organization in 1928 petitioner has maintained a record of the crude oil production of each separate oil well.

During the fiscal year ended September 30, 1936, petitioner wrote off as a loss consequent to the abandonment of its Red Ribbon well No. 6 in that year an amount of \$5,044.13, which said amount was computed as follows:

Total cost of tangible equipment capitalized..... \$9,093.60
 Less depreciation previously written off:

Year ended	Net Bbls. Produced after Royalty to Lessor— Red Ribbon Well No. 6	Unit Deprecn. Rate applicable to Red Ribbon Ranch Lease Well Equipment	Amount
Sept. 30, 1930	12,421	\$.032668392	405.77
Sept. 30, 1931	22,876	.032668392	747.32
Sept. 30, 1932	41,285	.032971291	1,361.22
Sept. 30, 1933	37,847	.032920749	1,245.95
Sept. 30, 1934	8,785	.032920749	289.21
Sept. 30, 1935	None	.	None
Sept. 30, 1936	None		None
Total			4,049.47
Abandonment Loss			5,044.13
			[141]

During the fiscal year ended September 30, 1937, petitioner wrote off as losses consequent to the abandonment of its McKeehan wells Nos. 1 and 3 and its Earl Fruit Co. well No. 1 a total amount of \$35,026.52, which amount was computed as follows:

Loss on McKeehan Well No. 1

Total cost of tangible equipment capitalized.....\$22,304.17
 Less depreciation previously written off:

Year ended	Net Bbls. Produced after Royalty to Lessor— McKeehan Well No. 1	Unit Deprecn. Rate applicable to McKeehan Lease Well Equipment	Amount
Sept. 30, 1934	105,426	\$.043556776	4,592.02
Sept. 30, 1935	114,161	.063458951	7,244.54
Sept. 30, 1936	40,122	.063458951	2,546.10
Sept. 30, 1937	8,300	.063458951	526.71
Total			14,909.37
Loss on McKeehan Well No. 1.....			7,394.80

Loss on McKeehan Well No. 3

Total cost of tangible equipment capitalized.....	16,542.36
Less salvage value of tangible equipment removed from well	1,479.75
Balance of equipment abandoned.....	15,062.61
Less depreciation previously written off:	

Year ended	Net Bbls. Produced after Royalty to Lessor— McKeehan Well No. 3	Unit Deprecn. Rate applicable to McKeehan Lease Well Equipment	Amount
Sept. 30, 1935	9,218	\$.063458951	584.96
Sept. 30, 1936	5,938	.063458951	376.92
Sept. 30, 1937	None		—
Total			961.88

Loss on McKeehan Well No. 3.....	14,100.73
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Loss on Earl Fruit Company Well No. 1

Total cost of tangible equipment capitalized.....	15,735.91
Less salvage value of tangible equipment removed from well	2,204.92
Balance	13,530.99
Depreciation previously written off.....	None

Petitioner did not adjust the cost of well equipment on account of depreciation in its computation of loss on the abandonment of the Earl Fruit Co. lease well No. 1 because at the time of closing its books for the fiscal year ended September 30, 1936, it had no reliable engineering reports as to the possible potential crude oil production from this lease and accordingly had insufficient data to compute de-
[142]preciation with respect to the lease for the year and did not compute any depreciaton in its books nor claim any depreciation in its income tax return with respect to the lease for the year. Respon-

dent computed and allowed depreciation applicable to the well equipment located on the Earl Fruit Co. lease for the year ended September 30, 1936, as follows:

	Total Cost of Tangible Eqpt.	Less estimated Salvage 10%	Balance subject to Deprecn.	*Unit Cost (Per Bbl.)	Net Production after Royalty to Lessor Bbls.	Deprecn.
Well No. 1.....	\$15,735.91	\$1,573.59	\$14,162.32		2,884.00	
Well No. 2.....	4,003.29	400.33	3,602.96		None	
Total	19,739.20	1,973.92	17,765.28	\$0.1188687	2,884.00	\$342.82

*Based on total net potential production (after deduction of royalty to lessor) of 149,453 barrels of crude oil.

In his final determination of tax for the fiscal year ended September 30, 1936, the respondent disallowed the claimed deduction of \$5,044.13 consequent to the abandonment of petitioner's Red Ribbon Ranch lease well No. 6 and similarly disallowed during the fiscal year ended September 30, 1937, claimed deductions totaling \$35,026.52 consequent to the abandonment of petitioner's McKeehan lease wells Nos. 1 and 3 and Earl Fruit Co. lease well No. 1, for the following reasons:

(b) On your return you claimed the deduction of \$5,044.13 in the fiscal year ended September 30, 1936 (and \$35,026.52 in the fiscal year ended September 30, 1937) as a loss sustained through abandonment of oil well equipment at oil wells shut down during the taxable year although other wells on the same leaseholds continued to operate.

You elected and have continued to deduct depreciation on your oil well equipment on your income tax returns on a unit of production basis based upon the total estimated production of oil to be obtained from an entire leasehold.

Since your tangible oil well equipment installations on each leasehold in question consist of more than one installation and depreciation has been based upon the average lives of all such installations, losses claimed on the normal retirements of such assets are not allowable inasmuch as an average rate contemplates a normal retirement of assets both before and after the average life has been reached and there is therefore, no possibility of as-

certaining any actual loss under such circumstances until all assets contained in the group have been retired or disposed of.

Therefore the losses claimed in the respective years are disallowed as deductions. See Article 23 (e)—3, Regulations 94 and 101.

Article 23 (e)—3 of Regulations 94 and 101, in so far as pertinent herein, is set forth in the margin.¹
[143]

(1) Art. 23 (e)—3. Loss of useful value.— * * *

If the depreciable assets of a taxpayer consist of more than one item and depreciation, whether in respect of items or groups of items, is based upon the average lives of such assets, losses claimed on the normal retirement of such assets are not allowable inasmuch as the use of an average rate contemplates a normal retirement of assets both before and after the average life has been reached and there is, therefore, no possibility of ascertaining any actual loss under such circumstances until all assets contained in the group have been retired. In order to account properly for such retirement the entire cost or other basis of assets retired, adjusted for salvage, will be charged to the depreciation reserve account, which will enable the full cost or other basis of the property to be recovered.

In cases in which depreciable property is disposed of due to causes other than exhaustion, wear and tear, and normal obsolescence, such as casualty, obsolescence other than normal, or sale, a deduction for the difference between the basis of the property (adjusted as provided in section 113 (b) and articles 113 (a) (14)—1, 113 (b)—1, 113 (b)—2, and 113 (b)—3) and its salvage value and/or amount realized upon its disposition may be allowed subject to the limitations provided in the Act upon deduction for losses, but only if it is clearly evident that

The petitioner contends that the unit of production method used by it in determining depreciation on its oil well equipment contemplated that the lives of the oil wells on a particular lease would be the same, i. e., as long as the lease on which such wells are located was commercially productive, and that the abandonment of any well and the retirement of its equipment prior to the time the lease becomes commercially nonproductive are premature and hence abnormal. The petitioner also contends that, since the method used by it was not based upon the average life of the individual well upon a given lease but upon the life of the lease, which is co-extensive with the longest life of any well located on such lease, the losses claimed are allowable under the provisions of the last paragraph of article 23 (e)—3. (See note 1.)

The fallacy of petitioner's argument lies in the fact that it presupposes the life of the tangible equipment of a well to be coextensive with the life of the lease or so long as the lease on which the wells

such disposition was not contemplated in the rate of depreciation.

In the case of classified accounts, if it is the consistent practice of the taxpayer to base the rate of depreciation on the expected life of the longest lived asset contained in the account, or in the case of single item accounts if the rate of depreciation is based on the maximum expected life of the asset, a deduction for the basis of the asset (adjusted as provided in section 113 (b) and articles 113 (a) (14)—1, 113 (b)—1, 113 (b)—2, and 113 (b)—3) less its salvage value is allowable upon its retirement. * * *

are located is productive. It is common knowledge that some wells produce salt water and other deleterious substances that eat out the casing, tubing, rods, lead lines, and other equipment, necessitating replacements of tangible equipment during the productive life of such wells. On the other hand equipment in some wells may still have considerable useful life after a well becomes nonproductive. The fact that a well becomes nonproductive and is abandoned does not necessarily result in the complete loss of usefulness of the equipment thereon or accelerate its depreciation or constitute abnormal retirement of the equipment. Such equipment may be and often is used at other wells. The stipulation shows that the wells involved were abandoned, but there is no evidence showing that the equipment thereon was also abandoned because it had lost its usefulness or that the abandonment of the wells caused depreciation of the equip- [144] ment in excess of that normally sustained. Except that the stipulation shows that petitioner "wrote off" the amounts of \$5,044.13 and \$35,026.52 "as losses consequent to the abandonment of its" wells and claimed losses on its income tax returns in such amounts, there is no evidence that the equipment was actually retired or abandoned because it had lost its economic usefulness and had no more than scrap or salvage value or no value.

The method used by petitioner contemplates the recovery of the entire cost of the equipment over the productive life of the lease. This method contemplates a normal retirement of the equipment,

both before and after the average life has been reached. In the absence of a sale of the equipment for which the loss is claimed, or unusual or abnormal circumstances which result in its destruction, obsolescence, or accelerated depreciation, no retirement loss is allowable so long as the lease continues to produce and other equipment on the same lease is in use.

What was said in *U. S. Industrial Alcohol Co.*, 42 B. T. A. 1323, 1378-1379 (appeal pending, C. C. A., 2d Cir.), is equally applicable herein:

The principle to be applied to a composite rate in such a case as this, therefore, is that assets which are retired at the end of their normal life can not be permitted to furnish further compensation by way of a deduction for loss on retirement, even though they may be retired in advance of the average life of the entire group. Their early retirement will be compensated for by depreciation taken after the average period has passed.

What has been said, however, applies only to normal retirements; and the converse of the statement is also true. If assets are removed from the group as a result of abnormal retirements resulting from unanticipated causes occurring before the end of the normal life attributed to such assets in arriving at the composite rate, the resulting loss is the proper ground for a deduction. Such losses are not to be compensated for by way of depreciation. *Southland Coal Co.*, 16 B. T. A. 50, and if not permitted as deductions will prevent the final recovery of the entire original cost.

It was stipulated that well No. 6, Red Ribbon Ranch lease, was abandoned in the year ended September 30, 1936, and that wells Nos. 1 and 3, McKeehan lease, and well No. 1, Earl Fruit Co. lease, were abandoned in the year ended September 30, 1937, for the reason that such wells became nonproductive and that the petitioner wrote off as losses the respective amounts herein claimed. It is not the well which is subject to depreciation, but it is the equipment used in connection with the production of oil which is the subject of depreciation. The life of the well does not determine the life of the equipment. There is no evidence that the equipment had outlived its usefulness or that the retirement of the equipment was necessitated by unusual or abnormal circumstances. The evidence shows that well No. 6 produced a total of 123,214 barrels of oil. This is less than the average estimated oil reserve of the Red Ribbon Ranch lease. Such a showing, however, does not entitle petitioner to the deduction of a retirement loss under the circumstances [145] shown herein. See *Acme Manifolding Co.*, 24 B. T. A. 429, and *U. S. Industrial Alcohol Co.*, *supra*.

The petitioner argues that it ought to be permitted to deduct the losses claimed because it kept records of the capitalized cost of equipment and the production of each well. However, in determining the depreciation allowable in years prior to the abandonment of the well for the purpose of computing the loss sustained the petitioner multiplied

the annual production by the rate used in determining the depreciation allowance on the lease on which the well was located. As heretofore stated, such rate was based on the estimated oil reserve of the entire lease and the capitalized cost of all the oil well equipment on such lease, less 10 percent for salvage. The evidence fails to show the estimated oil reserve for any of the wells abandoned. Not having the estimated oil reserve of the individual wells, it is impossible to determine the rate of depreciation applicable to the equipment of each well on the unit of production basis, even though the cost of the equipment and production of each well is shown.

Respondent in his determination allowed the loss claimed on well No. 2, Earl Fruit Co. lease, and there is no dispute as to that item. Well No. 1 on that lease produced oil, and although for a comparatively short time, under petitioner's unit of production method for determining depreciation on well equipment there is no reason why the equipment in connection with this well should be treated differently from that of wells abandoned on leases while other wells on the same lease continued to produce, since the Earl Fruit lease continued to produce after well No. 1 thereon was abandoned. The fact that petitioner had not determined the estimated oil reserve of such lease at the time of closing its books for the fiscal year ended September 30, 1936, and did not deduct any depreciation is immaterial. From the stipulation it appears that the oil reserve was

later determined and in computing petitioner's tax liability for the year ended September 30, 1936, the respondent allowed depreciation on the unit of production basis employed by petitioner.

The petitioner relies in particular upon the case of Witherspoon Oil Co., 34 B. T. A. 1130, claiming that the precise question here involved was presented therein. A reference to the record of that case discloses that the issues raised involved only an alleged partnership loss and disallowance of "undepleted cost." The Board approved the action of the respondent as to these two issues. The decision entered therein was for the amounts of the deficiencies in taxes claimed by the respondent, no allowance being made upon recomputation of the deficiency under Rule 50 for any undepreciated costs of physical assets. Apparently the depreciation deductions allowed by the respondent in that case were not questioned.

Decisions will be entered for the respondent.

(Seal of the Tax Court of the United States.) [146]

The Tax Court of the United States
Washington

(Seal)

Docket No. 105967

MOHAWK PETROLEUM COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Board, as set forth in its Opinion, promulgated October 30, 1942, it is

Ordered and Decided: That there are deficiencies in income tax for the fiscal years ended September 30, 1936 and 1937 in the respective amounts of \$991.84 and \$15,603.44.

Enter:

(Signed) WILLIAM W. ARNOLD

Judge

Entered Nov. 4, 1942 [147]

The Tax Court of the United States
Washington

(Seal)

Docket No. 105968

ALFRED L. MARSTEN, JR.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Board, as set forth in its Opinion, promulgated October 30, 1942, it is

Ordered and Decided: That there is a liability at law and in equity on the part of this petitioner for income tax for the fiscal years ended September 30, 1936 and 1937, in the amounts of \$991.84 and \$15,603.44, respectively, together with interest thereon as provided by law, as transferee of the Mohawk Petroleum Company.

Enter:

(Signed) WILLIAM W. ARNOLD
Judge

Entered Nov. 4, 1942. [148]

The Tax Court of the United States
Washington

(Seal)

Docket No. 105969

LEWIS A. MARSTEN,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Board, as set forth in its Opinion, promulgated October 30, 1942, it is

Ordered and Decided: That there is a liability at law and in equity on the part of this petitioner for income tax for the fiscal years ended September 30, 1936 and 1937 in the amounts of \$991.84 and \$15,603.44, respectively, together with interest thereon as provided by law, as transferee of the Mohawk Petroleum Company.

Enter:

(Signed) WILLIAM W. ARNOLD

Judge

Entered Nov. 4, 1942. [149]

The Tax Court of the United States
Washington

(Seal)

Docket No. 105970

EDWIN V. McKENZIE,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Board, as set forth in its Opinion, promulgated October 30, 1942, it is

Ordered and Decided: That there is a liability at law and in equity on the part of this petitioner for income tax for the fiscal years ended September 30, 1936 and 1937 in the amounts of \$991.84 and \$15,603.44, respectively, together with interest thereon as provided by law, as transferee of the Mohawk Petroleum Company.

Enter:

(Signed) WILLIAM W. ARNOLD

Judge

Entered Nov 4, 1942. [150]

The Tax Court of the United States
Washington
(Seal)

Docket No. 105971.

ESTATE OF ALFRED L. MARSTEN, Deceased,
EDWIN V. McKENZIE, Executor,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Board, as set forth in its Opinion, promulgated October 30, 1942, it is

Ordered and Decided: That there is a liability at law and in equity on the part of this petitioner for income tax for the fiscal years ended September 30, 1936 and 1937 in the amounts of \$991.84 and \$15,603.44, respectively, together with interest thereon as provided by law, as transferee of the Mohawk Petroleum Company.

Enter:

(Signed) WILLIAM W. ARNOLD
Judge

Entered Nov. 4, 1942. [151]

United States Board of Tax Appeals
(Now designated
“The Tax Court of the United States”)

Docket No. 105967

MOHAWK PETROLEUM COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 105968

ALFRED L. MARSTEN, JR.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 105969

LEWIS A. MARSTEN,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 105970

EDWIN V. McKENZIE,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

[152]

Docket No. 105971

ESTATE OF ALFRED L. MARSTEN, Deceased,

EDWIN V. McKENZIE, Executor,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

[153]

PETITION FOR REVIEW AND
ASSIGNMENTS OF ERROR

To The Honorable Judges of The United States
Circuit Court of Appeals for the Ninth Circuit:

The petitioners in this cause, Mohawk Petroleum Company, a California corporation, Edwin V. McKenzie as Executor of the Estate of Alfred L. Marsten, Deceased, Edwin V. McKenzie, an individual, Alfred L. Marsten, Jr., an individual, and Lewis A. Marsten an individual, by their attorneys, Edwin V. McKenzie and Jacob H. Sapiro, hereby file their petition for a review by the United States Circuit Court of Appeals for the Ninth Circuit, of the de-

cision by the United States Board of Tax Appeals, rendered on November 4, 1942 (47 B.T.A.-130) in the case of Mohawk Petroleum Company against Commissioner of Internal Revenue, Docket No. 105967, Alfred L. Marsten, Jr. against Commissioner of Internal Revenue, Docket No. 105968, Lewis A. Marsten against Commissioner of Internal Revenue, Docket No. 105969, Edwin V. McKenzie against Commissioner of Internal Revenue, Docket No. 105970, and Estate of Alfred L. Marsten, Deceased, against Commissioner of Internal Revenue, Docket No. 105971, which were consolidated for hearing and decision, and which determined deficiencies in the petitioner Mohawk Petroleum Company's Federal income taxes and undistributed profits for the fiscal [154] year ended September 30, 1936 in amount of \$991.84, and for the fiscal year ended September 30, 1937 in amount of \$15,603.44, and respectfully show:

I.

That petitioner, Mohawk Petroleum Company, is, and at all times mentioned herein was, a corporation duly organized and existing under and by virtue of the laws of the State of California, with its principal office at San Francisco, California; that petitioner, Edwin V. McKenzie, as Executor of the Estate of Alfred L. Marsten, is the duly appointed, qualified and acting Executor of the Estate of Alfred L. Marsten, Deceased, and at the time of his death a resident and inhabitant of San Francisco,

California; said decedent died, testate, on March 4, 1937. His will was admitted to probate in the Superior Court of the State of California, in and for the City and County of San Francisco, on March 19, 1937, on which said date said Edwin V. McKenzie then and there became, and ever since has been, and now is, Executor of said will and estate.

That the petitioners, Alfred L. Marsten, Jr., Lewis A. Marsten, Edwin V. McKenzie, are, and each of them is, an individual; all petitioners reside in and are inhabitants of San Francisco, California. The returns for the periods here involved were filed by each of said petitioners with the Collector of Internal Revenue for the First District of California. [155]

Petitioner, Alfred L. Marsten, Jr., is the owner of 3600 shares, petitioner Lewis A. Marsten is the owner of 3600 shares, petitioner Edwin V. McKenzie is the owner of 1,000 shares, and petitioner Edwin V. McKenzie as Executor of the Estate of Alfred L. Marsten, Deceased, is the owner of 52,300 shares of the capital stock of Mohawk Petroleum Company. The said Company distributed all of its assets to its stockholders prior to October 4, 1940. Each of the petitioners except Mohawk Petroleum Company received a portion of the assets of said Mohawk Petroleum Company as a liquidating dividend. Other than Mohawk Petroleum Company, each of the petitioners admits that he is a transferee of the assets of the said Mohawk Petroleum Company.

II.

The nature of the controversy is as follows:

The controversy involves the proper determination of the liability of petitioner, Mohawk Petroleum Company, for Federal income and undistributed profit taxes for the fiscal years ended September 30, 1936 and September 30, 1937. The notice of deficiency was mailed to said petitioners on October 4, 1940. The deficiencies asserted and set forth therein are \$991.84 for the fiscal year ended September 30, 1936, and \$15,603.44 for the fiscal year ended September 30, 1937, and a total of \$16,595.28.

The petitioners other than Mohawk Petroleum Company, in [156] dockets No. 105968, No. 105969, No. 105970, and No. 105971, are admittedly transferees of the assets of Mohawk Petroleum Company and liable, as such transferees, for any deficiencies determined against Mohawk Petroleum Company herein, together with interest thereon, as provided by law. Hereinafter, reference will be made to Mohawk Petroleum Company as petitioner.

The petitioner has consistently closed its books and filed its income tax returns on the basis of a fiscal year ending September 30th. During the said tax years of 1936 and 1937, petitioner abandoned four oil wells which had been capitalized on its books as follows:

Red Ribbon Ranch Lease, Well #6.....	\$ 9,093.60
McKeehan Lease, " #1.....	22,304.17
McKeehan Lease, " #3.....	16,542.36
Earl Fruit Co. Lease, " #1.....	15,735.91

All of these wells are situated in Kern County, California. In each of the three leases involved, other wells continued to produce after the several above-referred-to abandonments. The detail of these leases and wells is set forth in the stipulation of facts presented to the United States Board of Tax Appeals, which is part of the records herein.

Ever since the organization of petitioner in 1928, it has consistently deducted intangible development costs in connection with drilling oil wells as expense, and has capitalized the cost of tangible oil well equipment. The cost so capitalized of each well was set up separately in petitioner's books and in accordance with the above list. [157]

Ever since its organization the petitioner has depreciated the tangible well equipment connected with the wells on each lease on the "unit of production" method, such method being applied in such manner and with such records that the amount of depreciation taken with each well was determinable. Depreciation for each lease was determined (after a ten per cent reduction for salvage value) annually, by multiplying (1) the depreciation rate by (2) the barrels of oil produced by the several wells on the lease. A separate depreciation reserve account was kept for the depreciation relating to each lease. Ever since its organization petitioner maintained records of the barrels of oil produced by each well. Therefore it was immaterial whether depreciation was computed (1) by multiplying the production of each well by the rate and aggregating

the depreciation thus computed as to each well, or (2) by multiplying the aggregate production of all wells by the rate. From either method the same total of depreciation results. That part of the total depreciation, developed by the second method, applicable to either or any of the wells is determinable at any time by mere arithmetical calculation and with the same certainty as if the first method had been followed.

The petitioner abandoned the equipment connected with the certain wells here involved contemporaneously with the abandonment of the wells of which the equipment was an integral part.

During the fiscal year ended September 30, 1936, petitioner wrote off a loss consequent to the abandonment of [158] Red Ribbon Well #6 in that year in the amount of \$5,044.13. The detail of that computation is set forth in the agreed Statement of Facts before the United States Board of Tax Appeals.

During the fiscal year ended September 30, 1937, petitioner wrote off as losses consequent to the abandonment of the other three wells as follows:

McKeehan Well #1.....	\$ 7,394.80
McKeehan Well #2.....	14,173.00
Earl Fruit Co. Well #1.....	13,530.99

Total	\$35,026.52
-------	-------------

In his final determination of tax for the fiscal year ended September 30, 1936, the respondent disallowed the foregoing items for the following reasons:

“(b) On your return you claimed the deduction of \$5,044.13 in the fiscal year ended September 30, 1936 (and \$35,026.52 in the fiscal year ended September 30, 1937) as a loss sustained through the abandonment of oil well equipment at oil wells shut down during the taxable year although other wells on the same leaseholds continued to operate.

You elected and have continued to deduct depreciation on your oil well equipment on your income tax returns on a unit of production basis based upon the total estimated production of oil to be obtained from an entire leasehold.

Since your tangible oil well equipment installations on each leasehold in question consist of more than one installation and depreciation has been based upon the average lives of all such installations, losses claimed on the normal retirements of such assets are not allowable inasmuch as an average rate contemplates a normal retirement of assets both before and after the average life has been [159] reached and there is therefore, no possibility of ascertaining any actual loss under such circumstances until all assets contained in the group have been retired or disposed of.

Therefore the losses claimed in the respective years are disallowed as deductions. See Article 23 (e)-3, Regulations 94 and 101.”

That thereafter the petitioners herein duly filed a petition in the United States Board of Tax Appeals claiming a reduction of said deficiencies in the sum of approximately \$900.00 for the 1936 fiscal year,

and the sum of approximately \$9,000.00 for the 1937 fiscal year by virtue of the abandonment of the said wells, together with the well equipment therein.

That in due course the said appeal to the United States Board of Tax Appeals came on for hearing and was submitted upon agreed and stipulated facts. That thereafter the said Board entered its findings of fact, opinion and decision, in which it disallowed the said deductions claimed by the petitioners and determined the deficiencies for the fiscal years 1936 and 1937 as the same are fixed by the Commissioner of Internal Revenue. In its opinion the Board stated its reasons for its conclusions as follows:

1. That the method used by petitioner contemplates the recovery of the entire cost of the equipment over the productive life of the lease, and such method contemplates a normal retirement of the equipment both before and after the average life has been reached; that in the absence of a sale of the equipment or unusual or abnormal circumstances resulting in its destruction, [160] obsolescence, or accelerated depreciation, no retirement loss is allowable so long as the lease continues to produce, and other equipment on the same lease is in use.

2. That the stipulation of facts shows that the wells were abandoned but not that the equipment thereon was abandoned because it had lost its usefulness or that the abandonment of the wells caused depreciation of the equipment in excess of that nor-

mally sustained, nor that the equipment had outlived its usefulness nor that the retirement was necessitated by unusual or abnormal circumstances.

In due course, and on November 4, 1942, the said Board entered its decision pursuant to and in accordance with its said opinion.

III.

The petitioners, and each of them, being aggrieved by said opinion, decision and order of the United States Board of Tax Appeals, desires a review thereof, in accordance with the statutes in such case made and provided, by the United States Circuit Court of Appeals for the Ninth Circuit, within which circuit is located the office of the Collector of Internal Revenue wherein was filed the income tax returns of all of said petitioners for the years involved herein.

IV.

ASSIGNMENTS OF ERROR

The petitioners, and each of them, assign as error [161] the following acts and omissions of the Board of Tax Appeals:

(1) In the failure to allow as a deduction from petitioner Mohawk Petroleum Company's gross income for the fiscal year ended September 30, 1936, the depreciated value as capitalized on its books of the well equipment which was abandoned contemporaneously with the abandonment of Red Ribbon Ranch Lease Well No. 6, in the approximate sum of \$900.00;

(2) In the failure to allow as a deduction from petitioner Mohawk Petroleum Company's gross income for the fiscal year ended September 30, 1937, the depreciated value as capitalized on the books of the well equipment which was abandoned contemporaneously with the abandonment of McKeehan Lease Wells No. 1 and No. 3 and Earl Fruit Company Lease Well No. 1, in the approximate aggregate sum of \$9,000.00;

(3) In holding that physical equipment in oil wells on leased property where such equipment on each well is depreciated on the number of units (barrels of oil) that the entire lease is supposed to produce is the same as taking a "composite rate" of depreciation on all physical assets of the said petitioner;

(4) In holding, based on the assumption in Paragraph 3 herein, that because said petitioner is taking a composite rate of depreciation against any and all its assets it may not deduct in any one year a specific amount for abandonment of well equipment because abandonment is a normal incident of depreciation. [162]

(5) In holding that the depreciation rate allows for normal discards, or abandonment, and that no loss may be taken for them.

(6) In holding that any composite or average rate of depreciation necessarily includes all abandonments, however substantial in value; that a reserve for abandonments is included within such depreciation rate.

(7) In holding that the abandonment of an oil well and its equipment, however substantial its value, is an ordinary concomitant and corollary to depreciation and included within it; that the loss by abandonment is not such "an unusual or abnormal circumstance which results either in the destruction, obsolescence or accelerated depreciation".

(8) In holding that when an oil well is abandoned and its equipment is likewise abandoned, the latter is not necessarily abandoned because it has lost its usefulness, or that the abandonment of the well causes depreciation of the abandoned equipment in excess of the depreciation normally sustained.

(9) In holding that well equipment which is of that nature which requires abandonment when an oil well is abandoned has neither outlived its usefulness nor is occasioned by either unusual or abnormal circumstances.

(10) In the failure to hold that where well equipment is abandoned the remaining asset value is thereby reduced by the value of such abandoned equipment and there is only left the lessened value of the remaining equipment to thereafter depreciate. [163]

(11) In the failure to give effect to the statute law of the State of California, Act No. 4916, Statutes of 1915, Page 104, as amended; Statutes of 1931, page 1645, as amended; Statutes of 1929, page 924, as amended; Statutes of 1917, page 1586; 1919, page 1116; 1921, page 1724; 1929, page 923;

1931, page 1644; Vol. 2 General Laws of California (Deering's) page 2398, and specifically to Sections 3, 15 and 16 thereof, and regulations issued under and pursuant to its authority respecting the abandonment of oil wells and requiring that oil well casings be left in abandoned wells to prevent damage to petroleum and gas deposits from infiltrating water and to prevent damage to underground and surface water suitable for domestic and irrigating purposes.

(12) In the failure to give effect to Article 23 (m-18) of Regulations 94 of the United States Treasury Department, Bureau of Internal Revenue, issued under and pursuant to the Revenue Act of 1936, declaring that the depreciation of improvements in oil and gas wells is solely referable to depreciation and is not based in whole or in part on any reserve for the abandonment of any such equipment, the said regulations declaring the following principle:

“The amount deductible on this account (depreciation of improvements in the case of oil and gas wells) shall be such an amount based upon its cost or other basis equitably distributed over its useful life as will bring such property to its true salvage value when no longer useful for the purpose for which such property was acquired”. [164]

Wherefore, petitioners herein pray that this honorable Court may review said opinion, decision and order of the United States Board of Tax Ap-

peals, and reverse and set aside same; that a transcript of record be prepared in accordance with law and rules of this Court, and transmitted to the Clerk thereof for filing, and appropriate action be taken to the end that the manifest errors herein complained of may be reviewed and corrected by this Court.

Respectfully submitted,

JACOB H. SAPIRO

EDWIN V. McKENZIE

Attorneys for all of said
petitioners.

1049 Mills Building

San Francisco, California.

(Duly verified.)

[Endorsed]: T.C.U.S. Filed Jan. 29, 1943. [165]

[Title of Board and Causes.]

NOTICE OF FILING PETITION FOR
REVIEW [167]

To Honorable J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Washington, D. C.

You are hereby notified that the petitioners above named, to wit, Mohawk Petroleum Company, Alfred L. Marsten, Jr., Lewis A. Marsten, Edwin V. McKenzie, and Edwin V. McKenzie, Executor of the Estate of Alfred L. Marsten, Deceased, did on the 29th day of January, 1942, file with the Clerk of

the United States Board of Tax Appeals, now designated "The Tax Court of the United States", Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of the Board heretofore rendered in the above entitled proceeding. A copy of the petition for review and assignments of error as filed is hereto attached and served upon you.

Dated this 29th day of January, 1943.

EDWIN V. McKENZIE

J. H. SAPIRO

Attorneys for petitioners.

1049 Mills Building,

San Francisco, California.

[168]

Service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 29th day of January, 1943.

(Signed) J. P. WENCHEL

Chief Counsel, Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Filed Jan. 29, 1943. [169]

[Title of Board and Causes.]

PRAECIPE FOR RECORD [170]

To the Clerk of the United States Board of Tax Appeals (Now designated "The Tax Court of the United States"):

You will please prepare, transmit, and deliver to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, copies duly certified as correct of the following documents and records in the above-entitled proceedings in connection with the petition for review by the said Circuit Court of Appeals for the Ninth Circuit, heretofore filed by Mohawk Petroleum Company, Alfred L. Marsten, Jr., Lewis A. Marsten, Edwin V. McKenzie, and Edwin V. McKenzie, executor of the Estate of Alfred L. Marsten, Deceased, petitioners in said proceeding:

(1) Docket entries of the proceedings before the Board.

(2) Pleadings before the Board.

(a) Petitions filed herein, together with annexed copy of deficiency letter.

(b) Answers filed herein.

(3) Stipulation of facts filed March 25, 1942 at the hearing before the Board.

(4) Report of proceedings had at hearing by Board March 25, 1942.

(5) Findings of fact, opinion, orders and decision of the Board:

(a) Opinion promulgated and entered October 30, 1942; [171]

(b) Decisions entered November 4, 1942.

(6) Petition for review and assignments of error of petitioners, Mohawk Petroleum Company, Alfred L. Marsten, Jr., Lewis A. Marsten, Edwin V. McKenzie, and Edwin V. McKenzie, executor of the Estate of Alfred L. Marsten, Deceased, filed January 29th, 1943.

(7) Notice of filing petition for review addressed to Hon. J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, dated January 29th, 1943, together with acknowledgment of service endorsed thereon.

(8) This praecipe, together with proof of service.

JACOB H. SAPIRO

EDWIN V. McKENZIE

Attorneys for Petitioners.

[Endorsed]: T.C.U.S. Filed Jan. 29, 1943. [172]

[Title of Board and Causes.]

NOTICE OF FILING PRAECIPE [173]

To: Honorable J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Washington, D. C.

You are hereby notified that petitioners on review in the above entitled proceeding did on the 29th day of January, 1943, file with the Clerk of the United States Board of Tax Appeals (now designated "The Tax Court of the United States") a praecipe, a copy of which, as filed, is hereto attached and served upon you.

Dated this 29th day of January, 1943.

JACOB H. SAPIRO

EDWIN V. McKENZIE

Attorneys for Petitioners.

Personal service of the foregoing notice, together with a copy of the praecipe mentioned therein, is hereby acknowledged this 29th day of January, 1943.

Agreed to.

(Signed) J. P. WENCHEL

Chief Counsel, Bureau of Internal Revenue.

Attorney for Respondent.

[Endorsed]: T.C.U.S. Filed Jan. 29, 1943. [174]

[Title of Board and Causes.]

CERTIFICATE OF CLERK

I, B. D. Gamble, clerk of The Tax Court of the United States, do hereby certify that the foregoing pages, 1 to 174, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 16th day of February, 1943.

[Seal]

B. D. GAMBLE

Clerk, The Tax Court of the
United States.

[Endorsed]: No. 10373. United States Circuit Court of Appeals for the Ninth Circuit. Mohawk Petroleum Company, a California corporation, Edwin V. McKenzie, as Executor of the Estate of Alfred L. Marsten, deceased, Edwin V. McKenzie, Alfred L. Marsten, Jr., and Lewis A. Marsten, Petitioners, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review Decisions of the Tax Court of the United States.

Filed February 23, 1943.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

In the United States Circuit Court of Appeals
For the Ninth Circuit

No. 10373

MOHAWK PETROLEUM COMPANY, AL-
FRED L. MARSTEN, JR., LEWIS A.
MARSTEN, EDWIN V. McKENZIE, and
ESTATE OF ALFRED L. MARSTEN, De-
ceased, EDWIN V. McKENZIE, Executor,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

STATEMENT OF POINTS AND DESIGNA-
TION OF RECORD UNDER RULE 19

Pursuant to Rule 19, petitioners, Mohawk Petroleum Company, Alfred L. Marsten, Jr., Lewis A. Marsten, Edwin V. McKenzie, and Estate of Alfred L. Marsten, Deceased, Edwin V. McKenzie, Executor, submit herein their statement of the points on which they intend to rely in the above entitled action, and herein designate the portions of the record which they think necessary for the consideration of their petition to review the decision of the United States Board of Tax Appeals (now designated United States Tax Court), as follows:

1. Statement of Points: Said petitioners intend to rely on each and all of the points set forth in the Assignments of Error contained in their petition

for review, heretofore filed with the Clerk of the United States Board of Tax Appeals (now designated United States Tax Court), and, therefore, hereby adopt each and all of their said assignments of error as the points on which they intend to rely.

2. Said petitioners hereby refer to, and incorporate herein by reference, that certain "Stipulation Designating Portions of the Record to be Printed", dated February 13, 1943, and executed by counsel for the respective parties to the above entitled action, which said stipulation designates that certain portions of the record shall be printed, and petitioners hereby designate each and all of the documents and matters specified in said stipulation to be printed as the parts of the record which they deem material.

Dated: February 24, 1943.

Respectfully submitted,

EDWIN V. McKENZIE

J. H. SAPIRO

Attorneys for Petitioners.

Copy mailed to attorney for Commissioner of Internal Revenue, Feb. 24, 1943.

[Endorsed]: Filed Mar. 1, 1943. Paul P. O'Brien, Clerk.

[Title of Circuit Court of Appeals and Cause.]

STIPULATION DESIGNATING PORTIONS
OF THE RECORD TO BE PRINTED

It Is Hereby Stipulated by and between the petitioners above named and the respondent above named, that the Clerk of the above entitled Court shall print portions of the record in the above-entitled action hereinafter designated to be printed, and shall omit those portions of the record hereinafter designated to be omitted.

The following shall be printed:

(1) Docket entry of proceedings before the United States Board of Tax Appeals.

(2) The pleadings of the petitioner Mohawk Petroleum Company and the answers of the respondent to the five petitions.

(3) Stipulation of Facts filed March 25, 1942 in the hearing before the Board.

(4) Report of proceedings had at hearing by Board March 25, 1942.

(5) Opinion promulgated and entered October 30, 1942.

(6) Decisions of the United States Board of Tax Appeals entered November 4, 1942.

(7) Petition for Review and Assignments of Error of petitioners Mohawk Petroleum Company, Alfred L. Marsten, Jr., Lewis A. Marsten, Edwin V. McKenzie, and Estate of Alfred L. Marsten, Deceased, Edwin V. McKenzie, executor, filed January 29, 1943.

(8) Notice of filing petition for review addressed to the Hon. J. P. Wenchel, Chief Counsel for the Bureau of Internal Revenue, dated January 29, 1943, together with acknowledgment of service endorsed thereon.

(9) Praecipe for record filed with the Clerk of the United States Board of Tax Appeals (now designated Tax Court of the United States) on January 29, 1943; and

(10) Certificate of Clerk of the United States Board of Tax Appeals (now designated as Tax Court of the United States) certifying to said record.

There shall not be printed the following portions of the record:

(A) The petition of Alfred L. Marsten, Jr. (Docket No. 105968), excepting Paragraph 1 thereof, appearing on Page 29 of the record, and Paragraph (5) (a) thereof, appearing on Page 30 of the record, which read as follows:

“(1) The petitioner is an individual and resides in the City and County of San Francisco, State of California. His business address is 405 Montgomery Street, San Francisco, California. The returns for the periods here involved were filed with the Collector of United States Internal Revenue for the First District of California.

“(5) The facts upon which the petitioner relies as the basis for his proceeding are as follows:

(a) The petitioner was the owner of 3,600 shares of stock of Mohawk Petroleum Company. The said company distributed all of its assets to its stockholders prior to October 4, 1940. The petitioner received a portion of the assets of the said Mohawk Petroleum Company as a liquidating dividend. The respondent asserts and petitioner admits that he is a transferee of the assets of said Mohawk Petroleum Company”.

(B) The petition of Lewis A. Marsten (Docket No. 105969), excepting Paragraph 1 thereof, appearing on Page 52 of the record, and Paragraph (5) (a) thereof, appearing on Page 53 of the record, which read as follows:

“(1) The petitioner is an individual and resides in the City and County of San Francisco, State of California. His business address is 405 Montgomery Street, San Francisco, California. The returns for the periods here involved were filed with the Collector of United States Internal Revenue for the First District of California.

“(5) The facts upon which the petitioner relies as the basis for his proceeding are as follows:

(a) The petitioner was the owner of 3,600 shares of stock of Mohawk Petroleum Company. The said company distributed all of its assets to its stockholders prior to October 4, 1940. The petitioner received a portion of the

assets of said Mohawk Petroleum Company as a liquidating dividend. The respondent asserts and petitioner admits that he is a transferee of the assets of said Mohawk Petroleum Company”.

(C) The petition of Edwin V. McKenzie (Docket No. 105970), excepting Paragraph 1 thereof, appearing on Page 76 of the record, and Paragraph (5) (a) thereof, appearing on Page 77 of the record, which read as follows:

“(1) The petitioner is an individual and resides in the City and County of San Francisco, State of California. His business address is 1049 Mills Building, San Francisco, California. The returns for the periods here involved were filed with the Collector of United States Internal Revenue for the First District of California.

“(5) The facts upon which the petitioner relies as the basis for his proceeding are as follows:

(a) The petitioner was the owner of 1,000 shares of stock of Mohawk Petroleum Company. The said company distributed all of its assets to its stockholders prior to October 4, 1940. The petitioner received a portion of the assets of the said Mohawk Petroleum Company as a liquidating dividend. The respondent asserts and petitioner admits that he is a transferee of the assets of said Mohawk Petroleum Company”.

(D) The petition of the Estate of Alfred L. Marsten, Deceased, Edwin V. McKenzie, executor (Docket No. 105971), excepting Paragraph 1 thereof, appearing on Page 99 of the record, and Paragraph (5) (a) thereof, appearing on Page 100 of the record, which read as follows:

“(1) The petitioner is Edwin V. McKenzie as Executor of the Estate of Alfred L. Marsten, Deceased, and his address is 1049 Mills Building, San Francisco, California. The returns for the periods involved were filed with the Collector of United States Internal Revenue for the First District of California.

“(5) The facts upon which the petitioner relies as the basis for his proceeding are as follows:

(a) The petitioner was the owner of 52,300 shares of stock of Mohawk Petroleum Company. The said company distributed all of its assets to its stockholders prior to October 4, 1940. The petitioner received a portion of the assets of the said Mohawk Petroleum Company as a liquidating dividend. The respondent asserts and petitioner admits that he is a transferee of the assets of the said Mohawk Petroleum Company.”

It Is Further Stipulated that the printed petition of Mohawk Petroleum Company, together with the modifications and additions hereinabove set forth to be printed be deemed the petition of all the said five petitioners named in these proceedings.

Dated: February 13, 1943.

EDWIN V. McKENZIE

J. H. SAPIRO

Attorneys for Petitioners

SAMUEL O. CLARK, JR.,

Assistant Attorney General,

Attorney for Respondent.

[Endorsed]: Filed Mar. 1, 1942. Paul P.
O'Brien, Clerk.

No. 10,373

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

MOHAWK PETROLEUM COMPANY (a California corporation), EDWIN V. MCKENZIE, as Executor of the Estate of Alfred L. Marsten, Deceased, EDWIN V. MCKENZIE, ALFRED L. MARSTEN, JR., and LEWIS A. MARSTEN,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Upon Petition to Review Decisions of the Tax Court
of the United States.

OPENING BRIEF OF PETITIONERS.

JACOB H. SAPIRO,

EDWIN V. MCKENZIE,

Mills Building, San Francisco,

Attorneys for all Petitioners.

FILED

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PAUL P. O'BRYEN

Subject Index

	Page
A. The parties	2
B. Petitioner abandoned four oil wells.....	3
C. Commissioner's ground for the disallowance of the loss	4
D. The regulation under which the Commissioner acted...	4
E. Prior cases where this regulation has been construed and the Commissioner's rulings thereunder have been rejected	6
F. The general rule is that losses due to abandonments are allowable	7
G. The "unit of production" method of depreciation used by the petitioner	7
H. The petitioner's contentions	11
I. An analysis of the average method of depreciation ap- plied to varying physical lives of several articles.....	13
J. Where average rate was based on economic life of an oil field, abandonment loss was allowed.....	19
K. A comparison of Pipeline and Mohawk cases.....	24
L. The Brick case	37
M. The Witherspoon case	38
N. The mistaken assumption of the Board of Tax Appeals	39
O. Recoupment	44
P. Appendix	i

Table of Authorities Cited

Cases	Pages
Commissioner v. Wright, 47 Fed. (2d) 871.....	44
Crossett Lumber Co. v. U. S., 87 Fed. (2d) 930.....	47
Eau Claire, etc. Co. v. Commissioner, 65 Fed. (2d) 125....	43
Gooch Milling and Elevator Co. v. Commissioner, 133 Fed. (2d) 131	45, 46, 47
Illinois Pipeline Co. v. Commissioner, 37 B.T.A. 1070.....	
.....6, 20, 22, 23, 26, 27, 29, 34, 37	
Justice v. Burgess, 52 S. W. (2d) 720.....	44
Mason City Brick and Tile Co. v. Huston, 36 Fed. Supp. 515	6, 37
Newell v. Commissioner, 66 Fed. (2d) 102.....	44
Southland Coal Co. v. Commissioner, 16 B.T.A. 50.....	19
Underwood v. Commissioner, 56 Fed. (2d) 67.....	44
United States Industrial Alcohol Co. v. Commissioner, 42 B.T.A. 1323	2, 6, 13, 22, 27, 29, 32, 37
Witherspoon Oil Co. v. Commissioner, 34 B.T.A. 1130.....	38
Wyoming Investment Co. v. Commissioner, 30 Fed. (2d) 191	43

Codes

Revenue Act of 1936, Article 23 (E)-1.....	7
Revenue Act of 1936, Article 23 (F)-1.....	7

No. 10,373

IN THE
United States Circuit Court of Appeals
For the Ninth Circuit

MOHAWK PETROLEUM COMPANY (a California corporation), EDWIN V. MCKENZIE, as Executor of the Estate of Alfred L. Marsten, Deceased, EDWIN V. MCKENZIE, ALFRED L. MARSTEN, JR., and LEWIS A. MARSTEN,

Petitioners,

VS.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

**Upon Petition to Review Decisions of the Tax Court
of the United States.**

OPENING BRIEF OF PETITIONERS.

FOREWORD.

Annual depreciation on "wells equipment" was based by taxpayer on a "unit of production" method whereby the tax rate per barrel of oil produced was determined for each lease by dividing the capitalized cost of physical equipment (less salvage) by the estimated future production of the entire lease.

Under such method the amount of depreciation on each well and its equipment was determinable at all times. Four

wells were abandoned. Deduction for loss thereon was denied by the Commissioner on the ground that where an average depreciation on a group of items is taken **“based upon the average lives of such assets”** losses are not allowable because an average rate contemplates a normal retirement both before and after the average life is reached.

Petitioner asserts that the composite rate is not based upon the average life of physical assets but on the economic life of the oil lease. It presupposes that all of the equipment will last the life of, and that none of the assets could have a useful life longer than, the oil lease.

“Thus the depreciation there, and the deductions being calculated upon the maximum economic life of the entire plant, not the average life of separate assets, the loss deductions were proper.”

U. S. Ind. Alcohol Case (42 B.T.A. 1377-8, reviewing the Illinois Pipeline Case).

The sole reason of the rule adopted by the Commissioner is to prevent double recoupment by the taxpayer (1) by depreciation; and (2) by abandonment loss. No such result being possible under the method used by taxpayer, the application of the rule ceases with the absence of the reason therefor.

A. THE PARTIES.

This is a petition for the review by this Honorable Court of the decision by the United States Board of Tax Appeals rendered on November 4, 1942, reported in 47

B.T.A. 130 in the above entitled consolidated proceedings. (Tr. p. 67.)

Mohawk Petroleum Company is a California corporation with its principal office in San Francisco; reference will be made to it herein as "petitioner" because all other petitioners received its assets in liquidation as stockholders, and are liable as transferees for its tax deficiencies. Tax returns for periods involved were filed with the Collector of Internal Revenue for the First District of California. All petitioners are residents and inhabitants of the same district. (Tr. pp. 91-92.)

B. PETITIONER ABANDONED FOUR OIL WELLS.

Involved is the determination of liability of Petitioner for Federal income and undistributed profit taxes for 1936 and 1937 (fiscal year base). In those years Petitioner abandoned four oil wells situated on three separate leases in Kern County, California. In each instance other oil wells on the same lease continued to produce oil.

Since organization, Petitioner has consistently charged to expense intangible drilling cost; and, has capitalized separately the "well equipment" (casing, tubing, etc.) of each well. The abandoned wells were so capitalized.

On abandonment Petitioner deducted the cost of the well equipment, less salvage and prior depreciation, as a loss. By deficiency notice, the Commissioner disallowed same. These losses were: 1936, \$5,044.13; 1937, \$35,026.52. The tax deficiencies computed thereon were \$991.84 and \$15,603.44, respectively. Of those taxed sums, approxi-

mately \$900.00 and \$9,000.00 are referable to the issue here raised. (Tr. p. 93.) A most elaborate calculation is required to determine the precise amounts due to the necessity of adjusting allowable depletion which is contingent upon depreciation allowable and which is in turn contingent upon whether the abandonment losses herein contended for are allowable.

C. COMMISSIONER'S GROUND FOR THE DISALLOWANCE OF THE LOSS.

“Since your tangible well equipment installations on each leasehold in question consist of more than one installation and depreciation has been based upon the average lives of all of such installations, losses claimed on normal retirements of such assets are not allowable inasmuch as an average rate contemplates a normal retirement of assets both before and after the average life has been reached, and there is therefore, no possibility of ascertaining any actual loss under such circumstances until all assets contained in the group have been retired or disposed of”. (Tr. p. 18.)

D. THE REGULATION UNDER WHICH THE COMMISSIONER ACTED.

Article 23 (e)-3 of the Respondent's Regulations 94 with respect to the Revenue Act of 1936 contains the following paragraphs:

“If the depreciable assets of a taxpayer consist of more than one item and depreciation whether in respect of items or groups of items, *is based upon the average lives of such assets*, losses claimed on the

normal retirement of such assets are not allowable inasmuch as the use of an average rate contemplates a normal retirement of assets both before and after the average life has been reached and there is, therefore, no possibility of ascertaining any actual loss under such circumstances until all assets contained in the group have been retired. In order to account properly for such retirement the entire cost or other basis of assets retired, adjusted for salvage will be charged to the depreciation reserve account, which will enable the full cost or other basis of the property to be recovered”.

“In the case of classified accounts, if it is the consistent practice of the taxpayer to base the rate of depreciation on the expected life of the longest lived asset contained in the account, or in the case of single item accounts if the rate of depreciation is based on the maximum expected life of the asset, a deduction for the loss of the asset (adjusted as provided in section 113(b) and articles 113(2)(14)-1, 113(b)-1, and 113(b)-2 less its salvage value is allowable upon its retirement. (See articles 23(1)-1 to 23(1)-10.)” (Italics supplied.)

This regulation was formerly referred to as MIM. No. 4170.

The Treasury maintains that if taxpayers use depreciation rates based upon the average lives of depreciable assets instead of maximum lives, under the said regulations, losses on retirement are disallowable. Such disallowed losses are chargeable to the depreciation reserve. It maintains that the allowance of losses on retirement, in addition to the allowance of depreciation at the average rate, would result in the recovery by the taxpayer of all of

its investment by the end of the average life while still deriving the benefits from use of the substantial quantity of fully depreciated plant assets that possess a useful life beyond the average life. The facts in each case should govern.

A taxpayer using a composite or average rate should be allowed a loss if a change of conditions necessitates replacing any asset which had been in use for the period upon which the composite rate was in part based. To require that the loss be charged to the reserve would be to defer a deduction beyond the date of actual loss and the Treasury clearly intended, under the Regulation, to allow such a loss immediately.

**E. PRIOR CASES WHERE THIS REGULATION HAS BEEN CON-
STRUED AND THE COMMISSIONER'S RULINGS THERE-
UNDER HAVE BEEN REJECTED.**

Illinois Pipeline Co., 37 B.T.A. 1070 (June 21, 1938);

U. S. Industrial Alcohol Co., 42 B.T.A. 1323 (November 28, 1940);

Mason City Brick and Tile Co. v. Huston (D. C.),
36 Fed. Supp. 515 (January 3, 1941).

(Referred to herein as *Pipeline*, *Alcohol* and *Brick* cases.)

**F. THE GENERAL RULE IS THAT LOSSES DUE TO
ABANDONMENTS ARE ALLOWABLE.**

Revenue Act of 1936, Article 23 (E)-1—Loss by Individuals.

“Losses sustained by individual citizens or residents of the United States, and not compensated for by insurance or otherwise, are fully deductible if (a) incurred in the taxpayer’s trade or business, or (b) incurred in any transaction entered into for profit, or (c) arising from fires, storms, shipwreck or other casualty, or theft, and a deduction therefor has not, prior to the filing of the return, been claimed for estate tax purposes in the estate tax return, or (d) if not prohibited or limited by any of the following sections of the Act. * * * Full consideration must be given to any salvage value and to any insurance or other compensation received in determining the amount of losses actually sustained. See Section 113-B.”

Article 23 (F)-1—Losses by Corporation.

“Losses sustained by domestic corporations during the taxable year and not compensated for by insurance or otherwise are deductible except in so far as not prohibited or limited by Sections 23G-24A-6-112-117-118 and 251. The provisions of Articles 23(e)-1, 23(e)-2, 23(e)-3, 23(e)-4, 23(e)-5, and 23(h)-1 are in general applicable to corporations as well as individuals.”

**G. THE “UNIT OF PRODUCTION” METHOD OF DEPRECIATION
USED BY THE PETITIONER.**

Since its organization the Petitioner has consistently depreciated the tangible well equipment connected with the several wells on each lease on the “unit of production”

method, the method being applied in such manner that the amount of depreciation taken with each well (as distinguished from each lease) was determinable. Because the issues here are dependent on application of definite legal principles applicable to this method, we believe it necessary to amplify the mere abstract statement.

The amount in dollars of the annual depreciation was computed by multiplying two factors (a) the rate per barrel of oil produced during the year; and (b) the base, being the amount against which the rate was applicable.

The rate: a depreciation rate per barrel of oil produced was determined for each lease by dividing (1) the capitalized cost of physical "well equipment" (less salvage allowance) by (2) the estimated future production (oil reserves) of the entire lease.

By example:

	<u>Cost</u>	<u>Salvage</u>	<u>Net Base</u>
Well #1	10,000	10%	9,000
Well #2	15,000	10%	13,500
Well #3	20,000	10%	18,000
	<hr/>		<hr/>
Total	45,000		40,500

Estimated future production of lease in barrels of oil (oil reserves) 1,620,000 barrels. Therefore, $\$40,500 \div 1,620,000$ equals 2.5 cents per barrel, which is the rate.

The resultant rate per barrel was then multiplied by the barrels of oil produced each year by all wells on the lease to determine the depreciation for the year. If it be assumed that the actual production on the lease was as follows:

Well #1	20,000 barrels
“ #2	20,000 “
“ #3	41,000 “
<hr/>	
Total	81,000 “

Then the amount of depreciation to be charged would be: 81,000 (the base) by 2.5 cents (the rate) equals \$2,025.00.

Being a control account, Petitioner's books carried one depreciation reserve account for the equipment upon each lease but necessarily such account was built up by applying the depreciation rate per barrel to the production of each well; it is perfectly clear, therefore, that the figures reflected were a mere aggregate of those obtained by using the rate against the production of each well to obtain the amount of money to be charged against the depreciation reserve.

We emphasize this very important fact!

Consequently, the part of the reserve that was applicable to the abandoned well equipment was readily computable at any time on the basis of book entries, that is, known factors (the production of each well and the depreciation rate during each year).

By example:

Year 1934—Well #1	200,000 barrels
“ #2	300,000 “
“ #3	100,000 “
<hr/>	
	600,000 @ 2.5¢ \$15,000.00
Year 1935—Well #1	100,000 barrels
“ #2	200,000 “
“ #3	20,000 “
<hr/>	
	320,000 @ 2.5¢ 8,000.00

Reserve account balance, for first two	
years of production	\$23,000.00

If Well No. 3 is abandoned during 1935 it is obvious that the part of the \$23,000.00 balance that is applicable to its equipment is \$3000.00. If either of the other wells were abandoned during that year the respective amounts applicable would be Well No. 1, \$7500.00, and Well No. 2, \$12,500.00.

A new depreciation rate was computed whenever additional wells or additional capital items were added to existing wells during a year, or when it became appropriate, because of production experience, to increase or decrease the estimate of the remaining recoverable barrels of oil from a particular lease. When a well was abandoned the loss was determined and written off, such loss being measured by the excess of (1) the cost of the related physical equipment reduced by the salvage, if any, over (2) the prior depreciation which had been accounted in respect of such equipment.

It is concluded therefrom:

(1) That it was immaterial whether depreciation was computed (1) by multiplying the production of each well and aggregating the depreciation thus computed as to each well, or (2) by multiplying the aggregate production of all wells on a particular lease by the rate.

(2) That identically the same total of depreciation results from either method.

(3) That the part of the total depreciation developed by the second method (used by Petitioner) which is applicable to each well is determinable at any time by simple arithmetical process with the same accuracy as if the first method had been followed.

(4) That under the "unit of production" method as applied by Petitioner the amount of depreciation on each well and its equipment was determinable at all times.

H. PETITIONER'S CONTENTIONS.

The errors relied upon for reversal are those set forth in paragraphs 1 to 12 in assignments of error in the petition. (Tr. pp. 98 to 101.)

That there are two distinct classes of average or composite depreciation cases:

A. Where the composite rate is based on the average and varying physical lives of several articles (Alcohol case), and

B. Where the composite rate is based on the economic life of a group of articles as measured by something other than the physical lives of the several articles of the group, as here, by the production in barrels of oil from a particular field or lease (Pipeline case).

The "A" cases are divided into two classifications:

1. Where one or more of the articles comprising the average live a "normal" life yet less than the average no deduction for abandonment or retirement will be allowed because it would result in a double repayment to the taxpayer, (1) by depreciation, and (2) by abandonment loss. The lesser life of such an article has already been allowed by bringing a longer lived article down to the average; and

2. Where one (or more) of the articles (comprising the average) live less than its "normal" life as computed in arriving at the average, a deduction for loss by abandonment or retirement will be allowed of the capitalized cost, less salvage and prior depreciation.

The "B" cases have two classifications:

1. Where the economic life of an oil field is estimated in years (20) and a straight line depreciation (5%) is used a loss upon abandonment or retirement is allowable (Pipeline case); and

2. Where the economic life of an oil field is estimated by the number of barrels of oil it will produce, which estimate is adjusted by actual production so that depreciation extends until the last barrel of oil is actually produced, and the owner thereof obtains by way of depreciation and/or abandonment or retirement loss the precise amount of his capital investment in the physical equipment used to produce the oil, a loss upon abandonment or retirement is allowable (Mohawk case).

Petitioner concludes:

That the facts bring this case within "B-2"; that "B-2" and "B-1" are identical in principle.

That even if it be determined that the case is within "A" group it is within "A-2" and not within "A-1".

That to allow the loss cannot possibly result in a "double" return to the taxpayer.

That to deny the loss prevents the taxpayer from obtaining same when it occurs.

I. AN ANALYSIS OF THE AVERAGE METHOD OF DEPRECIATION APPLIED TO VARYING PHYSICAL LIVES OF SEVERAL ARTICLES.

U. S. Industrial Alcohol Company v. Commissioner,
42 B.T.A. 1323 (Nov. 28, 1940).

“A composite rate may be arrived at by taking average depreciation based upon the anticipated life of the assets concerned, weighted for their respective costs. The resulting rate is then applied to the entire group of assets involved.” (p. 1375.)

By example (A):

Article	Cost	Life	Dollar Life	Average life per Dollar-Cost	Annual rate of Depreciation
A	\$600.	x 8 yrs. =	\$4,800.		
B	400.	x 3 yrs. =	1,200.		
	<hr/> 1,000.		<hr/> 6,000.	6 years	16 $\frac{2}{3}$ %

(table supplied by Petitioner)

“* * * Under this theory of a composite rate, it is proper to eliminate from the base the cost of assets as they arrive at the end of their useful lives. This results from the fact that the composite rate is an average and that some assets will actually have a shorter and some a longer period of existence than the useful life appropriate to the average.” (Thus B article is shorter and A article is longer than the average life of six years.) “Only if the base is constantly reduced by the cost of the assets removed from it as they reach the end of their anticipated useful life will it be possible for the owner to continue to take depreciation deductions beyond the median point and while some of the longer lived assets are still necessarily employed.” (pp. 1375-6.)

In the above weighted average example, it is apparent that all the assets would be fully depreciated at the end of the sixth year and there would be nothing left against which to charge depreciation for the seventh and eighth years. An essential prerequisite to the proper operation of the composite method is the principle of a diminishing base against which depreciation is both charged and computed. Assume article "A" has lived precisely eight and article "B" three years.

By example (B):

	Article	Cost	Rate	Amount of Depreciation
1st year	A+B	\$1,000.	16 $\frac{2}{3}$ %	\$166.67
2nd year	A+B	1,000.	16 $\frac{2}{3}$ %	166.67
3rd year	A+B	1,000.	16 $\frac{2}{3}$ %	166.66
4th year	A	600.	16 $\frac{2}{3}$ %	100.00
5th to 8th years	A	4 x 600.	16 $\frac{2}{3}$ %	4 x 100.00

1,000.00 returned by
depreciation

(table supplied by Petitioner)

The base has been reduced at the end of the third year by the entire cost of "B" even though no deduction for retirement has been taken because its lesser life has been compensated by bringing the eight year life article to the average of six years. To allow a loss for its retirement in three years would operate to give a double deduction for (1) depreciation and (2) retirement. If, however, it be assumed that article "B" is retired at the end of one year the base must *then* be reduced by its cost.

By example (C):

	Article	Cost	Rate	Amount of Depreciation
1st year	A+B	\$1,000.	16 $\frac{2}{3}$ %	\$166.67
2nd year	A	600.	16 $\frac{2}{3}$ %	100.00
3rd to 8th years	A	600.	16 $\frac{2}{3}$ %	6 x 100.00
				<hr/>
				866.667 returned by depreciation
(Cost \$400—depreciation \$266.67)= used in computing average of six years.				133.333 returned by retirement allowance
				<hr/>
				\$1,000.000
(table supplied by Petitioner)				

A disallowance of the retirement loss would prevent taxpayer obtaining its cost within the eight year period.

This principle is applied in the opinion to a non-weighted average:

“A simple illustration will suffice. Assume five assets, each of the same cost basis, having anticipated useful lives of one through five years. The average life will be three years. On the theory that this calls for a depreciation rate of 33 $\frac{1}{3}$ %, that is also the weighted average since the costs are identical. Depreciation taken on the full original cost basis would exhaust the total investment at the end of three years and no depreciation would be allowable after that time, even though some of the assets would, by hypothesis, remain in use during the fourth and fifth years. Thus, for almost half the time, the taxpayer would be deprived of an annual deduction for depreciation” (p. 1376) (and his net income account distorted). See example D, *infra*. “If, however, the cost basis is reduced each year as one of the assets is removed from the group by

reason of normal retirement, and, assuming no replacements, the gradually diminishing base and hence the reduced amount of depreciation, will enable the taxpayer to continue to depreciate the assets remaining in each year at the composite rate throughout the fifth year and the result will be an exact recovery at that time of the original cost of all the assets. It follows that, if an asset forming part of a group subject to a composite depreciation rate is retired because it has reached the end of its normal life, only its elimination as the cause of additional deductions will avoid unnecessarily premature depreciation on the one hand or double deduction on the other." (p. 1376.) See example E, *infra*.

"The principle to be applied to a composite rate in such a case as this, therefore, is that assets which are retired at the end of their normal life cannot be permitted to furnish further compensation by way of a deduction for loss on retirement, even though they may be retired in advance of the entire group. Their early retirement will be compensated for by depreciation taken after the average period has passed."

Assume five articles with respective lives of 1 to 5 years. To determine between two methods of computation and to show the difference in *yearly* depreciation between them (although both result in a full return of the capital of \$50.) we make the comparison:

<u>Example E</u>		<u>Example N</u>	
Composite or Average Method		Straight Line Separately Computed	
	<u>Amount of Depreciation</u>		<u>Amount of Depreciation</u>
1st year.....	\$16.67		\$22.8333
2nd "	13.33		12.8333
3rd "	10.00		7.8333
4th "	6.67		4.5000
5th "	3.33		2.000
Total.....	\$50.00		\$50.00

Example N having served the purpose of illustration, is no longer significant here: it has served to make clear the statements in the Alcohol decision, and is foundational to the next and more important distinction.

We now compare Examples E and D.

<u>Example E</u>			<u>Example D</u>			
Capital	Rate	Amt. of Dep.	Cost	Bal. of Cost	Rate	Amt. of Dep.
1st year.....\$50.00 x 33 $\frac{1}{3}$ %		\$16.67	\$50.00	\$50.00	\$50 x 33 $\frac{1}{3}$ %	\$16.666
2nd " 40.00 x 33 $\frac{1}{3}$ %		13.33	50.00	33.33	50 x 33 $\frac{1}{3}$ %	16.666
3rd " 30.00 x 33 $\frac{1}{3}$ %		10.00	50.00	16.67	50 x 33 $\frac{1}{3}$ %	16.666
4th " 20.00 x 33 $\frac{1}{3}$ %		6.67				
5th " 10.00 x 33 $\frac{1}{3}$ %		3.33				
Total\$50.00 lost		\$50.00	\$50.00 lost			\$50.00
		gained				gained

Query: What is the average or composite method? Is it as reflected in Example "E" or Example "D"? The difference in yearly return is patent enough. But upon what principle is the difference predicated. We lay great stress upon the proposition.

The composite method is not an average rate over the average lives of the several articles; it is an average rate over the whole period measured by the life of the longest lived of the several articles.

It will be noted that the main factual difference is in the circumstance that in "D" all depreciation stops at the end of the third year and while articles 4 and 5 still have remaining lives of 1 and 2 years, whereas in "E" the base constantly diminishes as each of the five articles "lose their lives". Nevertheless the rate itself is the same as in "D"; it is an average and composite rate although applied to a diminishing base. The base diminishes, not in accordance with the amount of money charged as depreciation but because articles have been taken out of the base because the lives of such articles have expired causing retirement or abandonment. The Commissioner asserts a certain regulation is applicable; applying the controlling sentence thereof to the 1st and 2nd year articles of the example: "Their early retirement will be compensated by depreciation taken *after* the average period (3 years in the example) has passed". It conclusively follows that the regulation means Example "E" and not Example "D" because in "D" there is no depreciation taken after the average period. From this follows indubitably that wherever a composite or average method of depreciation is used, it means a constantly decreasing amount returnable "on the expected life of the longest lived asset contained in the account". The quoted language is from the same regulation relied on by the Commissioner and provides that under such circumstances, a deduction, less salvage, is allowable upon retirement.

We continue the quotation:

“What has been said, however, applies only to normal retirements; and the converse of the statement is also true. If assets are removed from the group as a result of abnormal retirements resulting from unanticipated causes occurring before the end of the normal life attributed to such assets in arriving at the composite rate, the resulting loss is the proper ground for a deduction. Such losses are not to be compensated for by way of depreciation, *Southland Coal Co.*, 16 B.T.A. 50, and if not permitted as deductions will prevent the final recovery of the entire original cost.” (pp. 1378-1379.)

Two important circumstances are noted in the above quotations; they have reference to (1) a true composite rate, and (2) varying physical lives of the several articles. Even under such circumstances, premature abandonments are allowable as deductions.

J. WHERE AVERAGE RATE WAS BASED ON ECONOMIC LIFE OF AN OIL FIELD, ABANDONMENT LOSS WAS ALLOWED.

All that has been hereinabove set forth was deemed by us necessary to an understanding of the general principles underlying all composite rate cases. We have been dealing with the subject of depreciation where the rate is fixed in reference to a particular standard, to wit: the varying physical lives of the several articles depreciated. We come now to that class of case where rates are computed on a standard other than varying physical lives of the several articles and where as a group a number of articles are de-

preciated against a wholly different standard—their utilitarian life in connection with a natural resource. The life of the resource and not the life of the equipment becomes the measure of the rate of depreciation. Such resource *itself* diminishes; it is a wasting asset in that as it is extracted the producible amount left represents not only the balance thereof but the remaining economic life of the equipment necessary to produce it.

In this classification there are two distinct methods of computation as exemplified in the *Pipeline* and the *Mohawk* cases. In both the same natural resource, oil, was the basis of dispute. In the *Pipeline* case depreciation was computed on an assumed life of two oil fields determined solely by the estimate of twenty years. It was never adjusted. The rate of depreciation was a flat 5 per cent. If that mode of determination is in legal effect the same as that used by Petitioner then it conclusively follows that the holding of the Board there ought to have been applied here. We proceed to show that the only difference between the two cases exists in favor of the *Mohawk* case, that even stronger reasons here exist for the invocation of the rule there applied.

Illinois Pipe Line Co. v. Commissioner, 37 B.T.A.
1070 (June 21, 1938):

The facts. The taxpayer was organized to take over the pipe line system of the Ohio Oil Company and to operate same as a common carrier. This pipe-line system consisted of main trunk pipe lines, feeder lines and gathering lines; pumping stations, and pumping buildings, tankage, etc. By the term “gathering lines” is meant smaller lines within an oil field to transport oil to a common point.

The system served several oil producing areas. Depreciation had been computed on all the depreciable assets by the taxpayer (and its predecessor) at an annual rate of 5% upon the theory that they had an economic life of twenty years dated from July 1, 1915, because the oil fields served had a probable economic life of twenty years dated from July 1, 1915, though the physical depreciation during the time it was operated by the predecessor was but 1% per annum.

Certain parts and sections of the line system were retired because the amount of oil produced in one field was so small that the line could not be profitably operated; one part of one of several parallel lines was sold and thereafter used by purchaser to transport natural gas. Another section was abandoned because the proration of oil production lowered the amount of oil carried in that line. There were other discards and abandonments of "laid pipe".

On retirement of general asset items the difference between cost and accrued depreciation, less salvage value, was written off (by being charged to retirement loss account). There was a difference in accounting for laid pipe. Investments on these items were kept according to the size of the pipe, as, for instance, the 8 inch was in one account, regardless of whether it was part of the original investment or subsequently purchased. When a section of such pipe was retired the amount credited to the investment account (and written off by being charged to retirement loss account) was computed by multiplying the number of feet of pipe retired by the average cost per foot of 8 inch pipe carried in the investment account on the date of the retirement. The amount so credited was diminished by a

percentage which was equivalent to the ratio of the total accrued depreciation in the depreciation reserve for 8 inch pipe to the total investment in 8 inch pipe and the balance, less salvage value, was charged to the retirement loss account. A similar procedure was followed in making adjustments to the "Pipe Line Construction" account for 8 inch pipe, the capital account which reflected the construction cost of the pipe lines retired.

"In its income returns for the years under review (1929 and part of 1930) the petitioner claimed retirement losses, computed in the foregoing manner, as deductions from gross income".

The amount involved on this issue (for both periods) was \$316,521.60. The deductions for abandonment and retirement losses were allowed in full by the Board.

The reasoning in the opinion for the determination is hereafter set forth in a quotation from the *Alcohol* case where a distinction is drawn between the two classes of cases.

This brings us to the difference in the facts in the *Alcohol Co.* and the *Pipeline Co.* cases. This clear distinction is drawn by the Board in the *Alcohol Co.* case. We quote:

"Even stronger reasons require that there be no excessive compensation by permitting loss deductions upon normal retirements. Since the composite rate assumes that some assets will be retired before, and some after the average, those reaching the end of their *expected* life, whether before or after the average, do not result in any loss. And to permit any to be taken would tend to cause double deduction even more certainly than would the failure to reduce the base. The

following statement in *Illinois Pipeline Co.*, supra, may at first glance appear to indicate the contrary: 'However, if the basis is reduced as assets are retired, the entire cost of the retired assets cannot be recovered unless the depreciated cost of the retired assets is allowed as a deduction at the time of their retirement'. *This statement was undoubtedly correct as applied to the facts in that case.* The 5 per cent rate used there was arrived at by assuming a 20 year life for all of the assets. It was the result of an anticipated destruction at the end of twenty years of the oil fields which were being served by the pipeline. It is evident that none of the assets under those circumstances could have had a useful economic life longer than 20 years, and, since the rate adopted was 5 per cent, assets having a shorter life than 20 years would be retired at a loss. Thus the depreciation there, and the deductions, *being calculated upon the maximum economic life of the entire plant*, not the average life of separate assets, the loss deductions were proper. * * * The statement quoted therefore, while expressing the rule applying to the facts in that case, is not to be considered as applicable to a case where a composite rate is arrived at by averaging rates appropriate to anticipated lives of varying lengths". (pp. 1377-8.)

"It is evident that none of the assets under those circumstances could have a useful life longer than 20 years, and, since the rate adopted was 5 per cent, assets having a shorter life than 20 years would be retired at a loss."

What is the precise meaning of this statement. Does something have to be added to apply it to the facts of the *Pipeline* case? To the end of the sentence should be added a phrase to express that which it necessarily

implies: The implied phrase is: "unless such 'shorter life' articles are permitted to remain in the account after retirement". It is evident that so remaining the entire value including that of the retired articles would be repaid at a 5% rate in twenty years. From this it follows that such articles must be retired from the base at the time of retirement. So construed (it seems the only reasonable construction) the same sentence is transposable to the facts of the instant case.

It is evident that none of the assets under those circumstances could have had a useful life longer than the life of the last barrel of oil produced, and since the rate adopted was computed by a ratio of remaining unproduced oil to the cost of equipment depreciated, such part of the assets having a shorter life than measured by the last barrel of oil produced would be retired at a loss "unless such shorter life articles are permitted to remain in the account after retirement".

K. A COMPARISON OF PIPELINE AND MOHAWK CASES.

Just as the quoted case, in the instant one, the depreciation is "keyed" to the production of the oil, not in fixed years but the actual life thereof, economic life of all articles rather than varying physical lives. We review the method used by petitioner: Assume 6 wells, each with a capitalized cost for well equipment of \$10,000.00. Salvage value is immediately deducted to obtain the net capitalized cost against which depreciation is chargeable. Oil reserves (future production) is 2,160,000 barrels; yearly production is 360,000 barrels.

By Example (F):

	A	B	C	D	E	F
	Original Cost less Salvage and previous Deprecia- tion	Amount of Deprecia- tion	Production per year in Barrels	Oil Reserves	Rate (A÷D)	Single Well Cost less Salvage and prior Deprecia- tion
1st yr.	\$54,000	\$9,000	360,000	2,160,000	2.5¢	\$9,000
2nd "	45,000	9,000	360,000	1,800,000	"	7,500
3rd "	36,000	9,000	360,000	1,440,000	"	6,000
4th "	27,000	9,000	360,000	1,080,000	"	4,500
5th "	18,000	9,000	360,000	720,000	"	3,000
6th "	9,000	9,000	360,000	360,000	"	1,500
Total	\$54,000		2,160,000			

NOTE: The rate in this instance is a constant because in each year, remaining capital cost is proportioned to oil reserve, both having diminished proportionately

Assume that at midnight December 31st of the 3rd year, three wells went to water and were abandoned and written off. The amount would be \$13,500.00 ($3 \times \$4,500.00$). There would remain a balance of capital cost of the same amount. If the oil reserves of the lease remained the same, we would recompute the adjusted account to obtain a new rate. (This procedure is necessary each year, in any event.)

By Example (G):

	A	B	C	D	E	F
	Original Cost less Salvage and previous Deprecia- tion	Amount of Deprecia- tion	Production per year in Barrels	Oil Reserves	Rate (A÷D)	Single Well Cost less Salvage and prior Deprecia- tion
4th yr.	\$13,500	\$4,500	360,000	1,080,000	1.25¢	\$4,500
5th "	9,000	4,500	360,000	720,000	1.25	3,000
6th "	4,500	4,500	360,000	360,000	1.25	1,500
	\$13,500		1,080,000			

There has been written off for depreciation \$40,500.00 and for abandonments \$13,500.00 and a total of \$54,000.00 the proper amount ($3 \times \$9,000.00 + 3 \times \$4,500.00$). If, on said abandonment, the oil reserves were cut in half or adjusted up or down, it would make not the slightest difference in the dollar depreciation, only the rate would be affected. Assume reserves are cut in half, the rate is doubled but the annual depreciation is the same; thus

By Example (H):

	A	B	C	D	E	F
	Original Cost less Salvage and previous Deprecia- tion	Amount of Deprecia- tion	Production per year in Barrels	Oil Reserves	Rate (A÷D)	Single Well Cost less Salvage and prior Deprecia- tion
4th yr.	\$13,500	\$4,500	180,000	540,000	2.5¢	\$4,500
5th "	9,000	4,500	180,000	360,000	"	3,000
6th "	4,500	4,500	180,000	180,000	"	1,500
		\$13,500	540,000			

Where a "normal" life asset is expired, it must be written off or else the base could never be reduced; likewise if retired before its normal life it must be written off *then* and not when its anticipated life span is terminated. After the life of an asset is passed, there is that much less in asset value to depreciate. This reasoning applies even to composite rates on varying lives of physical assets.

Here, exactly as in the *Pipeline* case, none of the assets could have a "useful economic life longer than" the n years necessary to recover the oil. The conclusion:

"Thus the depreciation there (in the *Pipeline* case) and the deductions being calculated upon the maximum eco-

economic life of the entire plant, not the average life of separate assets, the loss deduction was proper." (*Alcohol* case, p. 1378.)

It is evident that where asset depreciation is based on economic life of some use which itself will terminate without respect to the varying physical life of such asset, that there can never be a double return of the value and there does not exist a plausible reason for the denial of loss due to abandonments.

If we assume 10 articles as a unit each of the value of \$10,000.00 with a 20 year economic life with a straight line depreciation rate of 5% we will have the situation of the *Pipeline* case. No table is necessary to illustrate a simple deduction of \$5,000.00 per year. If four articles are retired and abandoned how is the computation made:

An Example (I):

		Amt. of Deprecia- tion	Abandon- ment	Deprecia- tion	Loss by Abandon- ment	Total Cost
1 yr.	\$100,000	\$5,000	A-Article	\$ 500 +	\$9,500	\$10,000
2 "	90,000	4,500	B-Article	1,000 +	9,000	10,000
3 "	80,000	4,000				
4 "	80,000	4,000	C-Article	2,000 +	8,000	10,000
5 "	70,000	3,500				
6 "	70,000	3,500	D-Article	3,000 +	7,000	10,000
7 "	60,000	3,000				
8th to 20th yrs.	780,000	39,000				
Dep.		66,500			33,500	
Abandonments		33,500				
Total		100,000				

As in the 5 article example (*Alcohol* case) the cost base is reduced not by cost of the article less depreciation but

by the *entire* cost including that portion already depreciated. An article lasted one and should have lasted twenty years, 5% of its life was allowed for depreciation for one year of use, 95% of its expected life failed to materialize; we deduct the actual loss of \$9,500.00 but we must decrease the base by its original cost because no part thereof can be thereafter the basis of further depreciation; if only \$9,500.00 is deducted from the base then the \$500.00 would remain therein and thereby be depreciated over the 19 remaining years and increase the total sum returned through depreciation by \$500.00.

Taking the same data as in the Example "F" we change the depreciation rate to a flat $16\frac{2}{3}\%$ upon the assumption that the life of the oil on the particular lease is six years thereby bringing it in principle within the facts in the *Pipeline* case (there it was 20 years at a 5% straight line rate).

By Example (J):

	Cost Less Salvage	Depreciation		Oil Production Barrels	Single Well Cost Less Salvage and Prior Deprecia- tion	Oil Reserves
		Rate	Amount			
1st year	\$54,000	x $16\frac{2}{3}\%$	\$9,000	360,000	\$9,000	2,160,000
2nd "	54,000	x $16\frac{2}{3}\%$	9,000	360,000	7,500	1,800,000
3rd "	54,000	x $16\frac{2}{3}\%$	9,000	360,000	6,000	1,440,000
4th "	54,000	x $16\frac{2}{3}\%$	9,000	360,000	4,500	1,080,000
5th "	54,000	x $16\frac{2}{3}\%$	9,000	360,000	3,000	720,000
6th "	54,000	x $16\frac{2}{3}\%$	9,000	360,000	1,500	360,000

We again assume that at midnight December 31st of the 3rd year 3 wells went to water, were abandoned and written off. The amount of the deductible loss would be

\$13,500.00 (3 x \$4,500.00). Now there is a change due to the circumstance that in the instant case there has been a constantly diminishing base, whereas in the *Pipeline* case there has been a constant base: both, however, result in the same amount of yearly depreciation. We now reduce the *base* by the entire original cost of the 3 abandoned wells to obtain the new base upon which to compute the remaining amount of the depreciation necessary to recapture the balance of the cost. Oil reserves remain the same.

By Example (K):

	Cost Less Salvage		Depreciation		Oil Production Barrels	Single Well Cost Less Salvage and Prior Deprecia- tion	Oil Reserves
			Rate	Amount			
4th year	\$27,000	x	16 $\frac{2}{3}$ %	\$4,500	360,000	\$4,500	1,080,000
5th “	27,000	x	16 $\frac{2}{3}$ %	4,500	360,000	3,000	720,000
6th “	27,000	x	16 $\frac{2}{3}$ %	4,500	360,000	1,500	360,000

And, as in the same example, used with reference to the Petitioner's case it would not make the slightest difference whether the oil reserves were adjusted up or down because here the depreciation amount is obtained by multiplying the diminished cost by the same flat rate of 16 $\frac{2}{3}$ %.

A much stronger showing is here made for the application of the principle which is the basis of the decision in the *Pipeline* case and which was unequivocally approved in the *Alcohol* case, the distinction resting in “varying physical life” and “economic life”. In the *Pipeline* case it was originally estimated that the two fields would each last twenty years; that's a round amount and clearly a guess which requires the kindest of consideration to call an estimate of their economic lives; the flat

rate of 5% based on a 20 year expectancy might easily be wrong either way, up or down. In any event some of the equipment did not last that long; whether it lasted its "normal" life no one can say and it is an immaterial and false factor to consider in an economic life case. That equipment abandonment loss was allowed even though the Commissioner asserted it was part of an average. Clearly it wasn't. Here, we use through the years an estimate of future oil reserves corrected from year to year as experience (trial and error) shows it to be too high or low and corrected finally to the actual barrels of oil produced. So that each barrel of oil produced is charged with the precise moiety of the value of the physical life actually required to produce it; when six wells were producing, the cost of well equipment of the entire six wells was the base of the rate; after 3 wells were abandoned all the remaining oil was produced solely by using the remaining three wells and certainly only those three wells can be chargeable either physically or in economic usefulness with depreciation based on the value of equipment to produce the remaining oil.

A sum of money is invested in six wells on one oil lease for the economic purpose of producing an estimated amount of oil (oil reserves). If the same sum of money is capitalized it does not make any difference, in fixing the *rate*, whether there are three or six wells. Respecting the capital account, the sole question is the amount of money in that account. That sum of money is one of two factors which go to make up the rate. The other factor is the amount of oil remaining in the ground which in the future will be obtainable. Each year both of these

factors are reduced. The capital account is reduced by that sum of money representing prior depreciation which has already been charged to the account. The balance is a new factor for the year to be computed. Oil being a fixed supply, and a diminishing asset, the amount of oil reserves has been lessened by the amount produced in the prior years. That balance of oil reserves is, likewise, a new factor. So, the new balance of the capital account is divided by the newly computed oil reserves and a new rate is produced, unless, by coincidence, both the capital account and the oil reserve account decreased precisely in proportion, then the new rate would be the same for both years. In making these computations no reference is made nor consideration given to the varying physical life of wells, equipment, or oil wells, or the economic life, except to measure oil reserves against that part of the capital account remaining un-depreciated. The rate being a constant figure for that one accounting period, it is applied to all the producing wells in the *precisely* proportioned production, and, naturally, relatively as well, because the production of oil on the lease is multiplied by the rate to determine the depreciation write-off. The production of each well separately set up in the records is aggregated to obtain this fact. Assume that at midnight on December 31st, a well "goes to water" and is permanently abandoned. We have a capital account which contains this abandoned well, that is, its cost, less salvage, less prior depreciation. The balance is a dead flat loss to its owner. What reason exists to deny the deduction? Has it served to bring down to an average the "well equipment" on the remaining and still producing wells? And, referring to the five-year example

in the *Alcohol* case, has this one year economic life served to bring the five year, on the average theory, to three years? Or the two-year article and four, to the composite of three years? Not at all. And, in an arithmetical sense, it is naive to claim it. The answer seems as certain as the most certain of all sciences gives to all such questions.

Suppose the well never produced: then, its value would never have been capitalized. And if the engineers computed the same reserves all would be produced from the other "well equipments", and the capital account would be less; therefore, the rate would be *less* because a lesser investment would be *used* to obtain the same amount of oil. And, if the oil reserve decreased pro-tanto to the number of wells remaining, the rate would be the same as if the abandoned well had itself been a producer. It is perfectly obvious that the abandoned well has fully served *its* economic usefulness; its life span has terminated *with* its oil supply. It has during its productive life *paid* its way. Its cost is separately set up in the books. That separate cost is not commingled with the cost of any other well of the lease. After a salvage allowance, its net cost is written down each year at an amount per barrel, which is exactly the same amount per barrel that all the other wells on the same lease produced. The cost of each well is different, and the production of the wells varies.

But these differences were not the base of the depreciation. One well cost \$10,000.00 (after salvage allowance) and produced 500,000 barrels of oil; if the rate is one cent a barrel, abandonment brings a loss to its owner of \$5,000.00. Another well on the lease cost \$20,000.00, and produced 10,000 barrels, the rate being the same. The

residual balance of \$19,900.00 remains. All that balance will be eventually written off, exactly, to the last dollar, no more, no less. It does not make the slightest difference how much oil remains to be produced,—100 or 100,000 barrels—whether it captures the oil that the abandoned well might have produced or whether it fails to capture a barrel of it. The rate determines not only the amount of the return by depreciation, but the time element in recouping depreciation losses. This is because a rate is an annual percentage, a ratio of a *balance* of the capital account for that well to an estimated amount of oil remaining.

An estimate of the amount of oil remaining pertains to the beginning of the tax year, and the rate for that year is determined at the end of the year; that is, the *estimate* includes the amount produced during the year because the depreciation rate must, from first to last, exactly pay the capitalized cost. The rate per barrel depends on the number of barrels actually produced. In the last year of production the estimate at the beginning of the tax year is merely corrected to actual production when the wells, or well, is exhausted. Thus, we find that where deductions for abandonment are allowed, each well has paid exactly the amount of its capitalized cost, and in each accounting period each barrel of oil has had the same rate, the amount of the depreciation depending solely on its economic usefulness as measured by the barrel of oil. The only reason of the rule in the regulation is to prevent recoupment by the taxpayer for depreciation and then a double deduction, in whole or in part, by an abandonment, as clearly pointed out in the five-article example where

the one year having served to bring the five year article to the average of three; it could not be written off for abandonment at the end of its normal life because an average contemplates that depreciation will be taken after the average life, to-wit, in the fourth and fifth years. But even there the base of the capital account is decreased each year by the exact amount of the \$10 value; but the recoupment of that \$10 is in and a part of the depreciation returned for the year.

If depreciation represents the diminished value for decretion, an expiration of part of an estimated life, physically in the one instance, and an expiration of a part of its economic usefulness, measured functionally against a diminishing resource in the other, which conception is purely an empirical one and an expedient, how much more proper is it that allowance be made when the whole is gone, when actual physical life has terminated or its functional life expired, unless the method results in a double return by use of a formula which has already offset a short existence of one article against a long existence of another to establish a mean or average, or composite, exactly half-way between the two, a wholly non-existent circumstance here. How, then, may the estimate of a part of a value, the empirical, be allowed, and when the entire value, actual and not an estimate is certainly lost, that loss be denied?

As pointed out by the Board in the *Pipeline* case:

“The statute allows a taxpayer deductions for losses upon retirement of assets. It is of course proper to consider the method of computing depreciation and to see that double deductions do not result. There is

in the present case no distortion of income resulting from double deductions in this connection. On the contrary, if the retirement losses are disallowed, the deduction for depreciation would have to be increased in order to reflect income correctly" (p. 1081.)

Assume an oil lease with ten producing wells each having a tangible asset cost of \$20,000.00 capitalized on the books of the owner. Then assume a unit production method of depreciation is used based on its hypothetical oil reserves. Obviously, this is grounded on a primary assumption: that the capitalized value of the tangible assets (well equipment) will be *physically* used until all the recoverable oil is exhausted. But its life-years will gradually expire (decretion) so that when the time arrives when the oil is exhausted it has a remaining life measured only by the salvage ratio to cost of ten per cent. (Such salvage proportionate value being universally used and respecting the fairness thereof there has never been any question in the instant or in any other case.) This salvage rate is grounded upon the fact that a large proportion of "well equipment" is lost when the well is abandoned, to-wit, the surface string of pipe, the water string of pipe running from the surface to the oil sands, the liner, the packer, etc. The basis of the entire computation is the *entire investment* of well equipment so capitalized (10 wells x \$20,000.00 each equals \$200,000.00). Now assume 5 wells go suddenly to water and are abandoned. Instead of \$200,000.00 of capital assets being necessary to produce the remaining underground oil only \$100,000.00 is left. The \$100,000.00 must be written off irrespective of any question affecting income tax. Otherwise income is dis-

torted. It would be clearly a fraud on the part of a corporation against its stockholders to carry on its book non-existent assets and to falsify income for the year. So, the proper accounting procedure is to deduct from the cost (capitalized value) the amount of depreciation, if any, theretofore taken, further deduct the salvage value, and write off the balance.

The regulation itself provides that a deduction of an abandonment or retirement loss is allowable where the depreciation is based upon the expected life of the longest lived asset in the group.

“In the case of classified accounts, if it be the consistent practice of the taxpayer to base the *rate* of depreciation on the expected life of the longest lived asset contained in the account * * * a deduction * * * less its salvage value, is allowable upon its retirement.”

Average of terms, periods or lives, is the mean, a middle point between the high and low. Obviously, it is longer than that of the shortest lived unit of a group but shorter than the longest lived unit. It follows that where an average life is used, the capital account becomes fully depreciated before the final item included therein has been fully worn out and discarded. In the example used above, the entire capital account is exhausted in three years although Article “‘D’-4 year”, and “‘E’-5 year” have 1 and 2 years of life remaining. But under the “unit of production” method used by Petitioner, it is certain that the full capital investment could not be recovered until the last drop of oil is recovered. Instead of providing for a full recovery before the end of the life of the longest lived unit (as an average must necessarily allow, it being

an average and somewhere below the highest and above the lowest) as is *always* the case under average or composite life method, the procedure followed by Mohawk *did not permit the full recovery of cost until the end of the life of the longest lived unit (depreciable article) of the group*. Consequently, under the regulations there must be an allowable deduction for retirements, discards and abandonments. Either the quoted paragraph means precisely that which it directly and unequivocally states or it is meaningless, nullified by construction in denying a right created thereunder.

And, in any event, Petitioner's contention respecting this construction of the paragraph is identical with the construction placed thereon by the Board in the *Pipeline* and *Alcohol Company* cases, *supra*, and the District Court of the United States in the *Brick* case, *infra*.

L. THE BRICK CASE.

Mason City Brick and Tile Co. (D.C.), 36 Fed. Supp. 515-520.

A composite rate of depreciation was the basis of the computation on numerous items of equipment used in fabricating clay products. The Commissioner refused to allow loss deductions due to an abandonment because a composite depreciation rate was used and, therefore, the taxpayer should be left to realize recoupment over future years. The Court held:

“In this case, however, the amount of the loss was removed from the depreciation basis (same as in the instant case) so that the aggregate depreciation in future years would not include the diminution of

value through abandonment. * * * Any credit necessary to be made to the depreciation account to prevent double benefits to the taxpayer, if any, should be applied to years subsequent to 1936 and 1937. * * * I conclude the plaintiff's contention is the correct one and that plaintiff should be entitled to the reduction and consequently to recover the excess of tax exacted in accordance with law and the government's custom of payment in such cases."

M. THE WITHERSPOON CASE.

Witherspoon Oil Company, 34 B. T. A. 1130.

There, two questions were raised: Whether (1) undepleted cost of capitalized cost of intangible development (a question not here involved) and (2) undepreciated cost of capitalized physical equipment might be deducted upon abandonment of one or more wells on a given lease where other producing wells remained.

The Board held (1) that undepleted development cost was not deductible, but (2) that the undepreciated cost of the physical assets abandoned were deductible.

"In so far as the amounts here claimed represent undepreciated costs of physical assets * * * the petitioner is entitled to deductions upon abandonment of the wells to which they relate * * *" (p. 1137.)

The findings of fact (p. 1133) were:

"Petitioner did not keep separate depletion and depreciation accounts for each well. Such charges, when made, were in a lump sum for the entire Burke tract. As entries for depreciation and depletion were made as to each well a computation became necessary. The amounts used by the petitioner as depletion and de-

preciation in determining the loss on the abandonment of these wells was computed in the following manner:

The amount of depletion to be deducted for any given taxable year with respect to the lease as a whole was determined by dividing the amount of oil produced for that year into the amount of the reserve of estimated recoverable contents, thus obtaining the unit of depletion. The cost or other basis of the property was divided by the unit of depletion thus obtained to arrive at the amount of deductible depletion. The amount of depletion was then apportioned among each of the wells on the basis of the number of months that each well was producing. The amount of depletion allocable to a well down to the time of abandonment was used in computing the loss sustained on abandonment. The same method of apportionment was followed with respect to the computation of the depreciation allocable to the physical assets involved."

Also on pages 1131 and 1132 it is stated that:

"The cost, tangible and intangible, of each well drilled was capitalized and carried separately on the petitioner's books. Except for the first well drilled, and then only until the second well was brought in, the petitioner kept no production records of individual wells as the production from all the wells was run into field tanks where a production gauge was made of the oil."

N. THE MISTAKEN ASSUMPTION OF THE BOARD OF TAX APPEALS.

In the deficiency letter no question was raised by the Commissioner except the single issue of whether the regulation (Tr. p. 18) was applicable; no suggestion was made

that the abandonment of the well equipment had not occurred or that the useful life of said equipment was not thereupon lost to the Petitioner, nor that due allowance had not been made for salvage. In the presentation to the Board, counsel for the Commissioner raised no such questions; it was assumed by both litigants that the only question was the construction of the regulation.

If the decision of this Honorable Court is in favor of the construction of that regulation as urged by Petitioner, it would be most unfortunate if the case is decided upon an erroneous inference of fact drawn by the Board in its opinion. The Board declared:

“On the other hand, equipment in some wells may still have considerable useful life after a well becomes non-productive. The fact that a well becomes non-productive and is abandoned does not necessarily result in the complete loss of usefulness of the equipment thereon or accelerate its depreciation or constitute abnormal retirement of the equipment. Such equipment may be, and often is, used at other wells. The stipulation shows that the wells involved were abandoned, but there is no evidence showing that the equipment thereon was also abandoned because it had lost its usefulness or that the abandonment of the wells caused depreciation of the equipment in excess of that normally sustained. * * * There is no evidence that the equipment was actually retired or abandoned because it had lost its economic usefulness and had no more than scrap or salvage value or no value. * * * The life of the well does not determine the life of the equipment. There is no evidence that the equipment had outlived its usefulness or that the retirement of the equipment was necessitated by unusual or abnormal circumstances.”

When the term "oil well" is used, it has a definite, fixed meaning to all persons who are familiar therewith. It would be a mistake to assume that it consists of a hole in the ground only. A producing oil well is a integrated, composite, physical thing. First, a derrick is erected, in this instance wooden. In erecting the derrick, underneath the floor thereof there is a concrete foundation and the entire area is cemented. And in the center thereof is a cellar, or basement, concreted so that work can be done in connection with pipes underneath the derrick floor. When a well is "spudded" in and drilled, it is the usual practice to put into the well a surface string which, in the wells in question, run anywhere from 500-1000 feet, dependent upon where, in these upper strata, are pebbles or rocks. This is a mere structural entity, having no reference or no use when the well is completed. Its purpose is to facilitate drilling of the well and to prevent the upper formations caving in and pouring down on the drilling tools as the well is being drilled. When the oil sands are reached, it is necessary to set a string of pipe all the way to the surface. This is called the water string. The bottom sets in that impervious stratum immediately above the oil sands. Its purpose is to prevent the infiltration of upper waters into the oil horizon. When it is initially set, special cement is pumped in under great pressure so that the cement will go behind the pipe, between it and the surrounding earth, to constitute a solid block and to prevent water coming down between the pipe and the earth. When the oil sands are drilled out, a liner is placed in the well which runs to the bottom and the top of it is somewhere within the water string. This pipe is perforated so that the oil flows into the liner and usually

has sufficient pressure so that the oil runs up into the casing on a pumping well. And on a flowing well, the pressure is sufficient to build up a continuous stream from the liner to the surface—and hence cause the flow.

The life of an oil well is coexistent with the amount of oil which the well ultimately produces, both in a functional-use sense and as to the time or duration of its existence. The well is permanently abandoned because the owners know it will not produce oil at a profit, the most usual cause being infiltration of edge water. The well, all of it, has come to the end of its life. Eliminating salvage value, both the physical and functional life has ended. By abandonment is not meant that it remains merely idle and non-productive. It is destroyed forever. The word “abandonment”, in a generic sense, has a well-defined meaning: it is a permanent surrender, both in intent and act. But in relation to an oil well, it has a specific meaning. Under the laws of the State of California the producer is required to abandon oil wells under the supervision of the State Oil and Gas Supervisor. Specific reference to these statutes are set forth in Error No. 11. (Tr. p. 100.) The purpose of such supervised abandonment is two-fold:

(a) to protect the oil sands from infiltration of upper water (as distinguished from edge water in the same stratum); and

(b) to protect upper waters both for irrigation and domestic use from contamination by oil and gas.

The only means by which this is accomplished is to require that the water string remain in the well when it is abandoned. Even without such legal requirement it is rarely

possible to pull any part of the well casing where subject to lateral pressure of the earth; the only part capable of recovery, were it not for the inhibition of law, is that part of the water string which is within the surface string, and, hence, not at the point in contact with the earth.

The decision of the Board, therefore, went off on a mistaken assumption respecting facts wholly non-existent. It needs no extended argument to support the axiom that cases ought to be decided on actual and truthful facts, particularly where the facts are readily available, within the knowledge of both parties, and there is a procedural method by means of which the correct facts can be made of record and available to those Courts and Boards vested with authority to decide issues of law based thereon. And there can be no possible question that the Petitioner here could not reasonably anticipate the Board's decision in this respect and was misled by the circumstance that the Commissioner raised but one issue and made no suggestion that the physical equipment had not been abandoned or wholly lost, or that the entries respecting same on Petitioner's books were not truthful. In what appears to be a uniform line of decision, the Courts have held, particularly in tax cases, that if the Circuit Court of Appeals cannot make a final decision because of the absence of certain facts then the principle (the rule of decision) ought to be declared by it and the case remanded to the Board to take further testimony and to decide the case within the rule.

Wyoming Investment Co. v. Commissioner, 70 Fed. (2d) 191;

Eau Claire etc. Co. v. Commissioner, 65 Fed. (2d) 125;

Commissioner v. Wright, 47 Fed. (2d) 871;

Newell v. Commissioner, 66 Fed. (2d) 102;

Underwood v. Commissioner, 56 Fed. (2d) 67.

Here it was stipulated that the "wells equipment" was abandoned and that the salvage write-off was ten percent of cost. (Tr. pp. 49-58.) Under a fair and reasonable construction of the stipulation the Commissioner would be estopped to deny the facts. And, this estoppel runs against the Board of Tax Appeals.

"Abandonment consists of an actual act of relinquishment accompanied with the intent and purpose primarily to give up a claim and right of property."

Justice v. Burgess, 52 S. W. (2d) 720.

RECOUPMENT.

The Petitioner has concededly overpaid its income and excess profits tax for the year 1938 by the sum of \$5660.87; the Commissioner notified Petitioner by letter dated October 4, 1940 that if a claim of refund were made the same would be paid. It is, therefore, conceded that respondent owes Petitioner that sum, plus interest. The statute of limitations has run against any claim of refund which Petitioner might now file. The sum involved in the overpayment was solely occasioned by, and is the result of the ruling of the Commissioner disallowing the loss for abandonment claimed under the main issue here raised for the two years, 1936 and 1937. Because of that disallowance the base, that is the capitalized "wells

equipment'' was increased by the amount of items which Petitioner had previously written off (1936: \$5055.13; 1937: \$35,026.52) resulting in a tax for the succeeding year of \$5660.87. While the Commissioner did notify Petitioner that such claim of refund would be allowed if filed, yet Petitioner could not make such claim without admitting that the Commissioner's ruling was correct in not permitting the abandonment loss. An estoppel would prevent claiming a refund for a lesser amount while litigating a greater sum for the two previous years. The Petitioner would be entitled to the refund only if the Commissioner's disallowance of the abandonment loss was correct. Then, and now, Petitioner maintains error in that ruling. If, on that main issue, Petitioner has mistaken the law, and the taxes of 1936 and 1937 are increased by the sums claimed in the deficiency notice, *then* Petitioner would, for the first time, be permitted to claim an offset by the amount of the overpayment of 1938 taxes. This petition to review the decisions of the Tax Court of the United States was filed in that Court on January 29, 1943. On the same day the United States Circuit Court of Appeals, Eighth Circuit, rendered its decision in *Gooch Milling and Elevator Company v. Commissioner*, 133 Fed. (2d) 131, holding that the taxpayer there was entitled to an equitable recoupment and offset under facts paralleling those in the instant case; and, further holding (in effect) that it was error on the part of the Board to refuse the right to amend the petition, setting up as an alternative the recoupment defense.

All of the Petitioners pray leave to file an amendment of the petition in this proceeding setting forth the alterna-

tive defense of recoupment; that a copy of said proposed amendment is set forth in an appendix to this brief. While we urge this procedure of amendment as convenient and orderly, nevertheless, it is not, under the reasoning of the quoted case, necessary in view of the circumstance that full proof of the over-assessment appears of record. The proof of the claim and the amount determined is in the record (although the issue is not raised in either the original petition to the Board or in this petition to review the order and decision of the Board). Quoting the deficiency notice of October 4, 1940:

“You are advised that the determination of your income tax liability * * * discloses an over-assessment of \$5,660.87 for the taxable year 1938. * * *” (Tr. p. 14.)

And in the “Statement” of account (Tr. p. 15) is shown under the caption “Overassessment” the sum of \$5660.87, and the letter declares that a certificate of overassessment will issue in due course and that to prevent the operation of the statute of limitations a claim for refund should be filed. (Tr. p. 16.) The detailed computation of adjustments to net income for 1938, the explanation thereof and the computation of the tax are set forth. (Tr. pp. 26 to 31.)

Quoting from the *Gooch* opinion:

“This court has power to affirm, or if the decision of the Board is not in accordance with law, to modify or reverse the decision with or without remanding the case for a rehearing ‘as justice may require’. This we did in *Helvering v. Hormel*, 8th Cir. 111 F. (2d) 1, and the Supreme Court affirmed *Hormel v. Helvering*, 321 U. S. 552. In the *Hormel* case the

Supreme Court said, 'there may always be exceptional cases or particular circumstances which will prompt a reviewing or appellate court, where injustice might otherwise result, to consider the questions of law which were neither pressed nor passed upon by the court or administrative agency below'.

"In the instant case the doctrine of recoupment was pressed upon the Board. But if we have the right to consider the question if it had not been so presented to or passed upon by the Board, the fact that it was so presented, cannot deprive this court of the power to apply it here 'as justice may require'. The order appealed from is, therefore, reversed and the cause remanded to The Tax Court of the United States as successor to the Board of Tax Appeals for further proceedings consistent herewith."

On the merits of recoupment the opinion quotes with approval the statement in an earlier decision, *Crossett Lumber Co. v. U. S.*, 8th Cir., 87 Fed. (2d) 930:

"The basis of the doctrine is that principle of natural justice which denounces a claim as unjust, immoral and fraudulent when the claimant is at the same time wrongfully withholding money which in equity belongs to the other party."

If the decision of the Court in the *Gooch* case is correct, there can be no serious question that if the main issue should go against Petitioner, in any event, it is entitled to an offset in the sum of \$5660.87 plus interest.

Petitioners respectfully pray:

- (a) That the decision and order be set aside; or
- (b) To remand the cause to the Board of Tax Appeals to take testimony on the issue of whether there was an

actual physical abandonment of wells equipment to the loss of Petitioners and the value of salvage, if any; or

(c) To adjudge an equitable offset.

Dated, San Francisco,

April 7, 1943.

JACOB H. SAPIRO,

EDWIN V. MCKENZIE,

Attorneys for all Petitioners.

(Appendix Follows.)

Appendix.

Appendix

Proposed Amendment to the "Petition for Review and Assignments of Error".

By adding to Paragraph III (Tr. p. 98) thereof, the following:

III.

That the respondent adjusted the net income of Petitioner, Mohawk Petroleum Company, for the tax years 1936-1937 and 1938 by disallowing losses due to the abandonment of four oil wells hereinabove referred to; that the adjustment of the said net income for these three years was due to a single ruling that the said losses be added back to the capitalized "wells equipment" and computing depreciation for the year 1938 on said account so adjusted; that the income and excess profits taxes so computed reflected an overpayment of taxes by said Petitioner in the sum of \$5,660.87 for the year 1938.

By adding to Paragraph IV (Tr. p. 101) under the caption "Assignments of Error", the following:

(13) In the failure to allow as a deduction from Mohawk Petroleum Company's tax liability for the years 1936 and 1937 an overassessment and overpayment by said company in the sum of \$5660.87 for 1938 as an equitable recoupment and offset.

By adding to the prayer of the Petition, the following:

That in the event that this Honorable Court shall decide in favor of respondent and against Petitioners, adjudging a tax liability for the years 1936 and 1937, that the Petitioners be allowed an offset for the overpayment of \$5660.87 for the tax year 1938.

Respectfully submitted,

Jacob H. Sapiro,

Edwin V. McKenzie,

Attorneys for all of said Petitioners.

(To be verified.)

No. 10373

**In the United States Circuit Court of Appeals
for the Ninth Circuit**

MOHAWK PETROLEUM COMPANY, A CALIFORNIA CORPORATION,
EDWIN V. MCKENZIE, AS EXECUTOR OF THE ESTATE OF ALFRED L. MARSTEN, DECEASED, EDWIN V. MCKENZIE, ALFRED L. MARSTEN, JR., AND LEWIS A. MARSTEN, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX
COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

SAMUEL O. CLARK, Jr.,
Assistant Attorney General.

SEWALL KEY,
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Special Assistants to the Attorney General.

FILED

JUN - 7 1943

PAUL P. O'BRIEN,
CLERK

INDEX

	Page
Opinion below.....	1
Jurisdiction.....	2
Questions presented.....	2
Statutes and regulations involved.....	3
Statement.....	3
Summary of argument.....	10
Argument:	
I. The Tax Court correctly concluded that the taxpayer was not entitled to the retirement losses claimed on equipment used in connection with its abandoned oil wells.....	12
II. The Tax Court has no jurisdiction to apply, under the principle of recoupment, an overpayment of tax in a year where no deficiency has been found by the Commissioner against the deficiency in tax of the year before the Tax Court....	33
Conclusion.....	37
Appendix.....	38

CITATIONS

Cases:	
<i>Acer Realty Co. v. Commissioner</i> , 132 F. 2d 512.....	32
<i>Altschul, J. & O., Tobacco Co. v. Commissioner</i> , 42 F. 2d 609.....	32
<i>Brown v. Helvering</i> , 291 U. S. 193.....	26
<i>Commissioner v. Forest Glen C. Co.</i> , 98 F. 2d 968, certiorari denied, 306 U. S. 639.....	35, 36
<i>Crowell v. Commissioner</i> , 62 F. 2d 51.....	32
<i>De Loss v. Commissioner</i> , 28 F. 2d 803, certiorari denied, 279 U. S. 840.....	30
<i>Gooch Milling & Elevator Co. v. Commissioner</i> , 133 F. 2d 131.....	33
<i>Greenleaf Textile Corp. v. Commissioner</i> , 26 B. T. A. 737, affirmed, 65 F. 2d 1017.....	35
<i>Helvering v. Gowran</i> , 302 U. S. 238.....	32
<i>Illinois Pipe Line Co. v. Commissioner</i> , 37 B. T. A. 1070.....	16
<i>Lambert v. Commissioner</i> , 108 F. 2d 624.....	30
<i>Lucas v. American Code Co.</i> , 280 U. S. 445.....	26, 30
<i>Mason City Brick & Tile Co. v. Huston</i> , 36 F. Supp. 515.....	22
<i>Morrison Woolen Co. v. Commissioner</i> , 10 B. T. A. 8.....	35
<i>New Colonial Co. v. Helvering</i> , 292 U. S. 435.....	32
<i>Pacific National Co. v. Welch</i> , 304 U. S. 191.....	25
<i>Reinecke v. Spalding</i> , 280 U. S. 227.....	32
<i>St. Paul Union Depot Co. v. Commissioner</i> , 123 F. 2d 235.....	25
<i>Southern California F. Lines v. Commissioner</i> , 99 F. 2d 104.....	13
<i>Sprunt, Alexander, & Sen v. Commissioner</i> , 64 F. 2d 424.....	32

Cases—Continued.

	Page
<i>Standard Oil Co. v. Commissioner</i> , 43 B. T. A. 973, affirmed, 129 F. 2d 363.....	32
<i>United States v. White Dental Co.</i> , 274 U. S. 398.....	30
<i>U. S. ex rel. Girard Co. v. Helvering</i> , 301 U. S. 540.....	35
<i>U. S. Industrial Alcohol Co. v. Commissioner</i> , 42 B. T. A. 1323..	13
<i>Welch v. Helvering</i> , 290 U. S. 111.....	32
<i>White v. United States</i> , 305 U. S. 281.....	32
<i>Witherspoon Oil Co. v. Commissioner</i> , 34 B. T. A. 1130.....	30
Statutes:	
Internal Revenue Code, Sec. 1100 (U. S. C. 1940 ed., Title 26, Sec. 1100).....	35
Revenue Act of 1936, c. 690, 49 Stat. 1648:	
Sec. 23.....	38
Sec. 272.....	35, 38
Sec. 322.....	35, 39
Revenue Act of 1942, Public Law No. 753, 77th Cong., 2d Sess.,	
Sec. 504.....	34, 39
Miscellaneous:	
H. Conference Rep. No. 2586, 77th Cong., 2d Sess., p. 40.....	35
H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 172-173.....	35
Mim. 4170, XIII-I Cum. Bull. 59, 61-62 (1934).....	30
Mim. 4170 (Rev.), XV-2 Cum. Bull. 148, 150-151 (1936).....	30
T. D. 4612, XIV-2 Cum. Bull. 99 (1935).....	30
Treasury Regulations 86, Art. 23 (e)-3.....	30
Treasury Regulations 94:	
Art. 23 (e)-3.....	30, 40
Art. 23 (f)-1.....	42
Treasury Regulations 101, Art. 23 (e)-3.....	10, 30
Treasury Regulations 103, Sec. 19.23 (e)-3.....	30

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No. 10373

MOHAWK PETROLEUM COMPANY, A CALIFORNIA CORPORATION, EDWIN V. MCKENZIE, AS EXECUTOR OF THE ESTATE OF ALFRED L. MARSTEN, DECEASED, EDWIN V. MCKENZIE, ALFRED L. MARSTEN, JR., AND LEWIS A. MARSTEN, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

*ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX
COURT OF THE UNITED STATES*

BRIEF FOR THE RESPONDENT

OPINION BELOW

The only previous opinion in this case is the opinion of the Tax Court (R. 67-83), which is reported in 47 B. T. A. 952.¹

¹ With the proceeding involving Mohawk Petroleum Company, there were consolidated before the Board of Tax Appeals the proceedings of Alfred L. Marsten, Jr., Lewis A. Marsten, Edwin V. McKenzie, and Estate of Alfred L. Marsten, Deceased, Edwin V. McKenzie, Executor. The last named petitioners are admittedly transferees of the assets of the Mohawk Petroleum Company and liable, as such transferees, for any deficiencies determined against the Mohawk Petroleum Company, together with interest thereon as provided by law. (R. 67-68.)

JURISDICTION

This is a petition for review of federal income taxes for the fiscal years ended September 30, 1936, and September 30, 1937, in the amounts of \$991.84 and \$15,603.44, respectively. (R. 91.) The returns in respect of which the question of tax liability arises were filed with the Collector of Internal Revenue for the First District of California. (R. 92.) On October 4, 1940, the Commissioner mailed to taxpayer a notice of deficiency in the total amount of \$16,595.28. (R. 13-14.) Within 90 days thereafter and on December 19, 1940, taxpayer filed a petition with the Board of Tax Appeals for a redetermination of that deficiency under the provisions of Section 272 of the Internal Revenue Code. (R. 7-13.) The decisions of the Tax Court of the United States² sustaining the Commissioner's determination were entered on November 4, 1942. (R. 84-88.) The case is brought to this Court by petition for review filed on January 29, 1943 (R. 90-102), pursuant to the provisions of Sections 1141-1142 of the Internal Revenue Code.

QUESTIONS PRESENTED

1. Whether taxpayer, having consistently taken depreciation on oil well equipment on the unit of production method based on the estimated oil reserves of a lease and the cost of all well equipment thereon, is entitled to a loss deduction under Section 23 (f)

² As of October 22, 1942, by Section 504 of the Revenue Act of 1942 the name of the Board of Tax Appeals was changed to the Tax Court of the United States.

of the Revenue Act of 1936 upon the retirement of equipment used in connection with an abandoned well on the lease, although production continued on the other wells.

2. Whether the Tax Court has jurisdiction to apply, under the principle of recoupment, an overpayment of tax in a year where no deficiency has been found against the deficiency in the taxable year before the Tax Court.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the statutes and Treasury Regulations involved are set forth in the Appendix, *infra*, pp. 38-42.

STATEMENT

The facts as stipulated by the parties and found by the Tax Court are as follows (R. 49-58, 68-77):

The taxpayer, Mohawk Petroleum Company, was in the taxable years a California corporation and filed its returns with the Collector of Internal Revenue for the First District of California. The taxpayer has consistently closed its books and filed its income tax returns on the basis of a fiscal year ending September 30. (R. 68.)

The taxpayer acquired certain oil and gas leases upon lands in the Fruitvale Oil Field in Kern County, California, shortly after its organization in 1928. One of the leases so acquired was called the Red Ribbon Ranch lease. At the time of the acquisition of this lease there was a producing oil well located thereon.

Five additional wells were drilled on the Red Ribbon Ranch lease by taxpayer in 1929, 1930, and 1931, and all of the five wells became producing wells. All of the six wells located on the Red Ribbon Ranch lease continued to produce crude oil until during the fiscal year ended September 30, 1934, when one well became nonproductive. This well, taxpayer's Red Ribbon Ranch lease well No. 6, was finally abandoned in the fiscal year ended September 30, 1936. The other five wells located on the Red Ribbon Ranch lease continued to produce crude oil for several years after the year ended September 30, 1936. (R. 68-69.)

On December 12, 1932, the taxpayer entered into an oil and gas lease with E. B. and Frona McKeehan covering certain lands in the Weedpatch Oil Field in Kern County, California. During the fiscal year ended September 30, 1934, two producing oil wells were drilled on the McKeehan lease and during the fiscal year ended September 30, 1936, one producing oil well was drilled thereon. During the fiscal year ended September 30, 1937, wells Nos. 1 and 3 on the McKeehan lease became nonproductive and were abandoned. Well No. 2 on such lease continued to produce for several years after the fiscal year ended September 30, 1937. (R. 69.)

On March 17, 1936, the taxpayer entered into an oil and gas lease with the Earl Fruit Company, a corporation, covering certain lands in Kern County, California. During the fiscal year ended September 30, 1936, one oil well was completed on the Earl Fruit Company lease and during the fiscal year ended Sep-

tember 30, 1937, two additional wells were completed on that lease. Earl Fruit Company lease well No. 1 started production of crude oil in August, 1936, and became nonproductive in May, 1937, and was abandoned prior to September 30, 1937. Well No. 2 on the Earl Fruit Company lease was completed in January, 1937, but it was not a commercially productive well and was abandoned shortly after completion and the capitalized cost of the well was written off as a dry hole loss and allowed as such by the Commissioner in the fiscal year ended September 30, 1937. Earl Fruit Company lease well No. 3 was completed in March, 1937, and produced crude oil for several years after its completion. Two additional producing wells were later completed on this lease. (R. 69-70.)

Ever since its organization in 1928 taxpayer has consistently deducted intangible development costs in connection with drilling oil wells as expense and has capitalized the cost of tangible oil well equipment. The cost so capitalized of each well was set up separately in the taxpayer's books. The cost so capitalized applicable to the wells here in question is as follows (R. 70):

Red Ribbon Ranch Lease Well No. 6-----	\$ 9,093.60
McKeehan Lease Well No. 1-----	22,304.17
McKeehan Lease Well No. 3-----	16,542.36
Earl Fruit Company Lease Well No. 1-----	15,735.91

Ever since its organization in 1928 taxpayer has consistently computed depreciation on the so-called unit of production method; that is to say, the annual depreciation applicable to the capitalized cost of oil well equipment located on a particular lease was de-

terminated by dividing the capitalized cost (after a 10 per cent reduction for estimated salvage value) of all the wells on a particular lease by the estimated net potential crude oil production of the lease, and the unit cost per barrel thus determined was then multiplied by the net number of barrels produced during the year from that particular lease to arrive at the amount of depreciation for the year. Estimated oil reserves and resulting unit cost per barrel were for an entire lease and the estimate was based upon the aggregate potential production of all wells and no separate determination of unit cost as to each separate well was made. (R. 70-71.)

The depreciation reserve account in the taxpayer's general ledger relating to depreciation on the capitalized cost of its oil wells is segregated as between the depreciation applicable to each separate oil lease, but is not segregated as between each separate oil well located on a particular lease. (R. 71.)

Ever since its organization in 1928 taxpayer has maintained a record of the crude oil production of each separate oil well. (R. 71.)

During the fiscal year ended September 30, 1936, taxpayer wrote off as a loss consequent to the abandonment of its Red Ribbon well No. 6 in that year an amount of \$5,044.13, which amount was computed as follows (R. 71-72):

Total cost of tangible equipment capitalized.....				\$9,093.60
Less depreciation previously written off:				
Year ended—	Net bbls. produced after royalty to lessor— Red Ribbon Well No. 6	Unit deprecn. rate applicable to Red Ribbon Ranch lease well equipment	Amount	
Sept. 30, 1930.....	12,421	\$0.032668392	\$405.77	
Sept. 30, 1931.....	22,876	.032668392	747.32	
Sept. 30, 1932.....	41,285	.032971291	1,361.22	
Sept. 30, 1933.....	37,847	.032920749	1,245.95	
Sept. 30, 1934.....	8,785	.032920749	289.21	
Sept. 30, 1935.....	None		None	
Sept. 30, 1936.....	None		None	
Total.....				4,049.47
Abandonment loss.....				5,044.13

During the fiscal year ended September 30, 1937, taxpayer wrote off as losses consequent to the abandonment of its McKeehan wells Nos. 1 and 3 and its Earl Fruit Company well No. 1 a total amount of \$35,-026.52, which amount was computed as follows (R. 72-73):

LOSS ON MCKEEHAN WELL No. 1

Total cost of tangible equipment capitalized.....				\$22,304.17
Less depreciation previously written off:				
Year ended—	Net bbls. produced after royalty to lessor— McKeehan Well No. 1	Unit deprecn. rate applicable to McKeehan lease well equipment	Amount	
Sept. 30, 1934.....	105,426	\$0.043556776	\$4,592.02	
Sept. 30, 1935.....	114,161	.063458951	7,244.54	
Sept. 30, 1936.....	40,122	.063458951	2,546.10	
Sept. 30, 1937.....	8,300	.063458951	526.71	
Total.....				14,909.37
Loss on McKeehan Well No. 1.....				7,394.80

LOSS ON MCKEEHAN WELL No. 3

Total cost of tangible equipment capitalized.....				\$16,542.36
Less salvage value of tangible equipment removed from well.....				1,479.75
Balance of equipment abandoned.....				15,062.61
Less depreciation previously written off:				
Year ended	Net bbls. produced af- ter royalty to lessor— McKeehan Well No. 3	Unit deprecn. rate applicable to McKeehan lease well equipment	Amount	
Sept. 30, 1935.....	9,218	\$0.063458951	584.96	
Sept. 30, 1936.....	5,938	.063458951	376.92	
Sept. 30, 1937.....	None			
Total.....				961.88
Loss on McKeehan Well No. 3.....				14,100.73
LOSS ON EARL FRUIT COMPANY WELL No. 1				
Total cost of tangible equipment capitalized.....				15,735.91
Less salvage value of tangible equipment removed from well.....				2,204.92
Balance.....				13,530.99
Depreciation previously written off.....				None

Taxpayer did not adjust the cost of well equipment on account of depreciation in its computation of loss on the abandonment of the Earl Fruit Company lease well No. 1 because at the time of closing its books for the fiscal year ended September 30, 1936, it had no reliable engineering reports as to the possible potential crude oil production from this lease and accordingly had insufficient data to compute depreciation with respect to the lease for the year and did not compute any depreciation in its books nor claim any depreciation in its income tax return with respect to the lease for the year. The Commissioner computed and allowed depreciation applicable to the well equip-

ment located on the Earl Fruit Company lease for the year ended September 30, 1936, as follows (R. 73-75) :

	Total cost of tangible eqpt.	Less estimated salvage 10%	Balance subject to deprecn.	Unit cost (per bbl.) ¹	Net pro- duction after royalty to lessor (bbls.)	Deprecn.
Well No. 1.....	\$15, 735. 91	\$1, 573. 59	\$14, 162. 32	-----	2, 884	-----
Well No. 2.....	4, 003. 29	400. 33	3, 602. 96	-----	None	-----
Total.....	19, 739. 20	1, 973. 92	17, 765. 28	\$0. 1188687	2, 884	\$342. 82

¹ Based on total net potential production (after deduction of royalty to lessor) of 149,453 barrels of crude oil.

In his final determination of tax for the fiscal year ended September 30, 1936, the Commissioner disallowed the claimed deduction of \$5,044.13 consequent to the abandonment of taxpayer's Red Ribbon Ranch lease well No. 6 and similarly disallowed during the fiscal year ended September 30, 1937, claimed deductions totaling \$35,026.52 consequent to the abandonment of taxpayer's McKeehan lease wells Nos. 1 and 3 and Earl Fruit Company lease well No. 1, for the following reasons (R. 76-77) :

On your return you claimed the deduction of \$5,044.13 in the fiscal year ended September 30, 1936 (and \$35,026.52 in the fiscal year ended September 30, 1937) as a loss sustained through abandonment of oil well equipment at oil wells shut down during the taxable year although other wells on the same leaseholds continued to operate.

You elected and have continued to deduct depreciation on your oil well equipment on your income tax returns on a unit of production based

upon the total estimated production of oil to be obtained from an entire leasehold.

Since your tangible oil well equipment installations on each leasehold in question consist of more than one installation and depreciation has been based upon the average lives of all such installations, losses claimed on the normal retirements of such assets are not allowable inasmuch as an average rate contemplates a normal retirement of assets both before and after the average life has been reached and there is therefore, no possibility of ascertaining any actual loss under such circumstances until all assets contained in the group have been retired or disposed of.

Therefore the losses claimed in the respective years are disallowed as deductions. See Article 23 (e)-3, Regulations 94 and 101.

The Commissioner's determination was upheld by the Tax Court. (R. 83.)

SUMMARY OF ARGUMENT

I

Taxpayer, having consistently taken depreciation on its oil well equipment on the unit of production method based on the estimated oil reserves of a lease and the cost of all equipment thereon, is not entitled to a loss deduction on the normal retirement of equipment used in connection with an abandoned well on the lease while the lease is producing from other wells located thereon. The rate of depreciation computed by taxpayer represents an average of the different rates that would have resulted had the reserves of each well

been separately estimated and applied to the cost of the particular equipment serving that well. By treating each lease hold and all the equipment serving that leasehold as a single economic unit, and readjusting the estimated oil reserves thereon in light of actual experience, taxpayer adopted a scheme which would not only return through depreciation allowances the cost of its assets in accordance with production, but which would also return the total cost of its investment when the last barrel of oil was extracted. There is therefore no room for permitting a loss deduction on the normal retirement of some assets in the group as long as other assets are still being used in connection with producing wells on the lease.

The claimed deduction should be denied in any event since there is nothing in the record to indicate that the well equipment in fact became permanently worthless during the taxable years involved. Although certain wells were abandoned, the equipment previously used at those wells might have been available for use elsewhere. Since taxpayer must affirmatively establish every element of its claimed deduction by presenting a case coming squarely within the applicable statute, its failure to do so precludes the allowance of its claim, irrespective of the theory asserted by the Commissioner in denying the deduction.

II

In redetermining the amount of any deficiency for a taxable year before it, the Tax Court has no jurisdiction to determine whether or not the tax for any

other taxable year has been overpaid. Therefore, the deficiency resulting from disallowance of the claimed retirement losses for the taxable years before the Tax Court should not be reduced by recouping against that deficiency the amount by which taxpayer might have overpaid its taxes for a taxable year not before the Tax Court.

ARGUMENT

I

The Tax Court correctly concluded that the taxpayer was not entitled to the retirement losses claimed on equipment used in connection with its abandoned oil wells

We are here concerned with the question of whether taxpayer is entitled to a loss deduction for the undepreciated cost (less salvage value) of certain oil well equipment used in connection with four wells which it had been operating under three separate oil leases, and which wells it had abandoned during the taxable years involved.

1. Since the present case involves a group of assets, the depreciation on which taxpayer had computed by means of a composite rate, it would seem expedient at the outset to examine briefly some of the general principles applicable to composite rates of depreciation. Article 23 (e)-3 of Treasury Regulations 94 (Appendix, *infra*), provides that if the depreciable assets of a taxpayer consist of more than one item and depreciation in respect of those items is based upon their average lives, losses claimed on the normal retirement of such assets are not allowable. The theory of such a rule is, as the Regulations point out, that

the use of an average rate³ contemplates a normal retirement of assets both before and after the average life has been reached, and there is, therefore, no possibility of ascertaining any actual loss under such circumstances until all assets contained in the group have been retired.

The precise situation as above described was presented in *U. S. Industrial Alcohol Co. v. Commissioner*, 42 B. T. A. 1323, appeal pending in the Circuit Court of Appeals for the Second Circuit.⁴ There the composite rate was arrived at by taking the average anticipated normal life of the various assets comprising the group to which the rate was applied. In such case, assets which are retired at the end of their normal life will not be permitted to furnish further compensation by means of a deduction for loss on retirement, even though they are retired in advance of the average life of the entire group, because of the fact that their early retirement will be compensated for by depreciation taken after the average period has passed.

The principle and the method of its application can be explained in no better language than was employed

³ A taxpayer attacking a composite rate determined by the Commissioner must show error in the average before it can be said that the rate is not reasonable. Proving a shorter life for some items in the group is not enough. *Southern California F. Lines v. Commissioner*, 99 F. 2d 104 (C. C. A. 9th).

⁴ On appeal there was no dispute concerning the correctness of the basic principle that losses on the normal retirement of assets are not allowable where a composite rate of depreciation based on the average lives of those assets is used.

by the Board of Tax Appeals in its decision in the *Alcohol* case. To quote from that opinion (pp. 1375-76):

A composite rate may be arrived at by taking average depreciation based upon the anticipated life of the assets concerned, weighted for their respective costs. The resulting rate is then applied to the entire group of assets involved. This method of computation produces a convenient rule of thumb for calculating depreciation on a large number of assets, and if properly applied minimizes the possibility of double deductions. The latter requisite must constantly be adhered to in the application of methods of depreciation. *Illinois Pipe Line Co.*, 37 B. T. A. 1070, 1081.

Under this theory of a composite rate it is proper to eliminate from the base the cost of assets as they arrive at the end of their useful lives. This results from the fact that the composite rate is an average and that some assets will actually have a shorter and some a longer period of existence than the useful life appropriate to that average. Only if the base is constantly reduced by the cost of the assets removed from it as they reach the end of their anticipated useful life will it be possible for the owner to continue to take depreciation deductions beyond the median point and while some of the longer lived assets are still necessarily being usefully employed.

A simple illustration will suffice. Assume five assets, each of the same cost basis, having anticipated useful lives of one through five

years. The average life will be three years. On the theory that this calls for a depreciation rate of $33\frac{1}{3}$ percent, that is also the weighted average since the costs are identical. Depreciation taken on the full original cost basis would exhaust the total investment at the end of three years and no depreciation would be allowable after that time, even though some of the assets would, by hypothesis, remain in use during the fourth and fifth years. Thus, for almost half the time the taxpayer would be deprived of an annual deduction for depreciation. If, however, the cost basis is reduced each year as one of the assets is removed from the group by reason of normal retirement, and, assuming no replacements, the gradually diminishing base and hence the reduced amount of depreciation will enable the taxpayer to continue to depreciate the assets remaining in each year at the composite rate throughout the fifth year and the result will be an exact recovery at that time of the original cost of all the assets.

The situation involved in the *Alcohol* case may perhaps be further clarified by reference to a table of computations. Assume, as the Board suggested, five assets, each with the same cost basis of \$20,⁵ having anticipated normal useful lives of one through five years, i. e., one asset will be retired at the end of each year. The average life of these five assets is three

⁵ For the sake of convenience, in all cited examples the problem of weighting is taken care of by assuming that all assets have the same cost basis. Salvage value is also disregarded for purposes of simplification.

years. The depreciation rate, computed upon the basis of average life, will then be $33\frac{1}{3}$ per cent.

EXAMPLE 1

Years	Capital	Rate of depreciation (percent)	Amount of depreciation
1.....	100	$33\frac{1}{3}$	33.33
2.....	80	$33\frac{1}{3}$	26.67
3.....	60	$33\frac{1}{3}$	20.00
4.....	40	$33\frac{1}{3}$	13.33
5.....	20	$33\frac{1}{3}$	6.67
	¹ 100	-----	² 100.00

¹ Capital lost.

² Capital recovered through depreciation.

An entirely different situation is presented, however, if the composite rate used, rather than being based on the average lives of the assets in the group, is based instead upon the life of the longest lived asset in the group. *Illinois Pipe Line Co. v. Commissioner*, 37 B. T. A. 1070, involved such a case. There the taxpayer had deducted depreciation at a uniform rate on oil pipe lines, based upon the estimated economic lives of the oil fields which those lines served. When an asset was retired through abandonment or other disposition, the gross cost of the asset was eliminated from the asset account and the accumulated depreciation thereon was eliminated from the appropriate reserve account which was maintained for each class of assets. Any excess of cost over accumulated depreciation and salvage value was deducted as a loss on retirement. The Board of Tax Appeals ruled that the losses on retirements were properly deductible because the taxpayer's method, consistently applied, would fully return to the taxpayer its capital investment over the

period of the economic life of the equipment, would not result in any double deduction, and would not distort income for any year. Since the depreciation rate in the *Pipe Line* case was based upon the maximum economic life of the properties, any assets having a useful life less than the maximum life period used in computing the depreciation rate, and having served to reduce the basis upon which depreciation was computed when such assets were retired, would obviously be retired at a loss to the extent of their undepreciated cost. Unlike the situation in the *Alcohol* case, assets retired before the period upon which the depreciation rate is based would not be compensated for by depreciation taken after that period had passed. In the *Pipe Line* case, when the five-year period had passed, there would be no further depreciation to be taken. As the Board of Tax Appeals said in *U. S. Industrial Alcohol Co. v. Commissioner, supra*, in explaining its decision in the *Illinois Pipe Line* case (p. 1377) :

The 5 percent rate used there was arrived at by assuming a 20-year life for all of the assets. It was the result of an anticipated destruction at the end of 20 years of the oil fields which were being served by the pipe line. It is evident that none of the assets under those circumstances could have had a useful economic life longer than 20 years, and, since the rate adopted was 5 percent, assets having a shorter life than 20 years would be retired at a loss. Thus the depreciation there, and the deductions, being calculated upon the maximum economic life of the entire plant, not the average life of separate assets, the loss deduction was proper.

Thus Article 23 (e)-3 of the applicable Regulations in recognizing the soundness of the principles as above discussed, provides that only where a taxpayer has consistently computed depreciation on a composite rate based on the expected life of the longest lived asset contained in the group to which the rate is applied, will a loss deduction for the basis of the asset (generally its undepreciated cost) less its salvage value be allowed upon its retirement.

The situation presented by the *Pipe Line* case and the manner in which it differs from the *Alcohol* case can best be illustrated by a table. Assume, as previously, a taxpayer with a group of five assets, each asset costing \$20, and that during this five-year period one asset is retired at the end of each year due to normal depreciation. Assume here, however, that the depreciation rate, rather than being computed on the average life of the assets in the group, is computed on the basis of the longest lived asset, i. e., five years, or 20 per cent. The result would be as follows:

EXAMPLE 2

Years	Capital	Rate of depreciation (percent)	Amount of depreciation	Depreciation on asset retired	Loss on asset retired	Cost of asset retired
1.....	100	20	20	4	16	20
2.....	80	20	16	8	12	20
3.....	60	20	12	12	8	20
4.....	40	20	8	16	4	20
5.....	20	20	4	20	0	20
	¹ 100		² 60		³ 40	

¹ Capital lost.

² Capital recovered through depreciation.

³ Capital recovered through loss deduction.

An examination of the above table makes it clear that before a loss for the normal retirement of assets may be properly claimed within the principle of the *Pipe Line* case, at least two conditions must be met: (1) The composite rate of depreciation must be based on the expected life of the longest lived asset in the group, and (2) the rate of depreciation so obtained must be continued to be applied, even though as assets are retired experience makes it clear that some of the assets in the group in fact have a life shorter than the estimated life upon which the depreciation rate was computed.

To clarify the second condition mentioned—if, even though the composite depreciation rate is originally computed upon the basis of the expected life of the longest lived asset in the group, that rate is subsequently adjusted each year in light of actual experience as to the life of each asset, no deduction for retirement losses will be permitted, since the adjusted depreciation rate will in future years succeed in fully depreciating the total cost of each asset. That is, at the end of the useful life of the longest lived asset in the group, the cost basis of each asset will have been fully recovered through depreciation. Thus, in the example mentioned above, assume that the taxpayer having originally determined the depreciation rate on the basis of the expected life of the longest lived asset, i. e., five years, or 20 per cent, redetermines that rate at the end of the first year when the first asset is retired, on the basis that the maximum life of the longest

lived asset is now only four years, and redetermines the rate again at the end of the second year on the basis that the maximum life of the longest lived asset is now three years, and so on each year. In such case the result would be as follows:

EXAMPLE 3

Years	Capital	Rate of depreciation	Amount of depreciation
1.....	100	20% (5 years).....	20
2.....	80	25% (4 years).....	20
3.....	60	33 $\frac{1}{3}$ % (3 years).....	20
4.....	40	50% (2 years).....	20
5.....	20	100% (1 year).....	20
	¹ 100		² 100

¹ Capital loss.

² Capital recovered through depreciation.

The constant adjustment of the depreciation rate to accord with actual experience means that during the first year the rate was based on a five-year life, during the second year on a four-year life, during the third year on a three-year life, the fourth year on a two-year life, and the fifth year on a one-year life. The taxpayer therefore has not consistently based the rate of depreciation on the expected life of the longest-lived asset in the group, i. e., five years, but has, in effect, determined the depreciation rate upon the average life of the five assets, i. e., three years. The situation in Example 3 thus more nearly resembles Example 1, both methods of computation providing for full recovery of taxpayer's total investment through depreciation by the time the last asset is exhausted and there-

fore permitting no loss deductions during the years the assets are normally retired.⁶

2. The present case differs from any of the situations heretofore discussed in that here the rate of depreciation was computed not with regard to the estimated lives of the various depreciating assets, but by the so-called unit-of-production method. The rate of depreciation to be applied to each barrel of oil recovered from each leasehold was determined by dividing the total cost of all the physical equipment (less salvage) serving that leasehold by the estimated future production of the leasehold. The unit rate thus determined was then multiplied by the number of barrels of oil produced during the year from the particular lease to arrive at the amount of depreciation for the year. Taxpayer argues that the method of depreciation adopted by it brings it within the principle of the *Pipe Line* case and that the loss deduction claimed should, therefore, be permitted. We submit that the principle of that case can have no application here.⁷

⁶ The difference in the yearly amounts of depreciation as computed under the methods illustrated in Example 1 and Example 3 is, of course, due to the fact that in the former a fixed rate of depreciation is applied to a diminishing base, whereas in the latter an increasing rate is applied to a proportionately diminishing rate, resulting in a constant amount of depreciation. The net effect of both methods, however, is precisely the same.

⁷ Taxpayer also asserts (Br. 12), as an alternative theory (though it does not seriously press the argument), that the deduction claimed should be permitted because the retired assets in question actually lived less than their "normal" lives, that is, less than they would have lived had they undergone only wear and tear and normal obsolescence. It is true that Article 23 (e)-3 of Regulations 94 provides that where depreciable property is disposed of due to causes other than exhaustion, wear and tear, and

As previously pointed out, the theory of the *Pipe Line* case is that where a fixed composite rate of depreciation is computed on the basis of the expected life of the longest-lived asset in the group and continually applied, a deduction for assets retired before that time is permitted because such loss will not be compensated for by depreciation taken after that time. Only by permitting the loss deduction can a taxpayer in such a case fully recover his capital investment when the last of the assets is exhausted. By no stretch of the imagination can a comparable situation be said to exist here. In the instant case taxpayer did not estimate the oil reserve of each individual well and compute its depreciation rate upon the basis of that estimate coupled with the cost of the equipment of that particular well. Rather, in computing its depreciation rate, taxpayer based that rate upon the total estimated production of oil to be obtained from an entire leasehold and upon the total cost of all the equipment of the various wells serving that leasehold. By so doing it allocated to each barrel of oil recovered from the entire leasehold a pro rata share of the total cost of *all* the equipment serving the leasehold, ir-

normal obsolescence, such as casualty, abnormal obsolescence, or sale, and where it is clearly evident that such disposition was not contemplated in the rate of depreciation, a loss deduction for the asset disposed of is permitted. However, there was absolutely no evidence offered by taxpayer, nor is there anything in the record to indicate, that the well equipment in question was disposed of due to causes other than wear and tear and normal obsolescence. An examination of the record in *Mason City Brick & Tile Co. v. Huston*, 36 F. Supp. 515 (N. D. Iowa), relied on by taxpayer, reveals that the property there, unlike the assets here involved, was retired because of abnormal obsolescence.

respective of to what extent each piece of equipment actually served to produce that barrel of oil and even though a particular part of that group of equipment may have contributed not at all to the production of that oil. In other words, taxpayer chose to treat each leasehold and the entire equipment serving that leasehold as a single economic unit. By so doing it adopted a scheme which consistently provided for an equitable portion of the cost of the entire equipment to be spread ratably over each and every barrel of oil produced by the property, and a scheme which would not only return through depreciation allowances the capital invested in accordance with production, but which would return, when the last barrel of oil was extracted, every cent which had gone into producing that oil.

It is obvious, of course, that had taxpayer chosen to compute a single depreciation rate for the equipment on each well, based upon the estimated production of that well, the total depreciation taken during each year of operation would have been much different from the yearly depreciation allowances resulting from the method chosen. Thus if in taxpayer's Examples F and G (Br. 25), it had originally estimated the reserves of each well separately and determined a separate rate of depreciation for each well, a mathematical computation will reveal that total depreciation on the equipment of the six wells during the first three years would have been \$12,000 each year, not \$9,000, and that depreciation on the remaining equipment after three wells had been abandoned at the end of

the third year would thereafter have been \$6,000 per year for the last three years.⁸ But by treating each leasehold and the equipment thereon as a single economic unit and basing its depreciation rate on that unit as a whole, taxpayer chose to adopt a method that would level off its depreciation cost irrespective of the fact that the reserves of some wells on that particular leasehold might be less (and the depreciation rate therefore greater) than other wells, and irrespective of the fact that some wells would therefore be retired before others. By estimating total reserves for the entire leasehold, taxpayer arrived at a rate of depreciation that represents an average of the different rates that would have resulted had the reserves of each well been separately estimated and applied to

⁸ Thus if a separate depreciation rate had been applied to the equipment on each well on the basis of that well's estimated reserves, the result would be as follows:

(a) For the three wells abandoned at the end of the third year:

	A Original cost less prior de- preciation	B Amount of depre- ciation	C Produc- tion per year in barrels	D Oil reserves	E Rate (A ÷ D) (cents)
1st year	27,000	9,000	180,000	540,000	5
2d year	18,000	9,000	180,000	360,000	5
3d year	9,000	9,000	180,000	180,000	5
	-----	27,000	540,000	-----	-----

(b) For the three wells which operated for six years:

1st year	27,000	3,000	180,000	1,620,000	1.66 $\frac{2}{3}$
2d year	24,000	3,000	180,000	1,440,000	1.66 $\frac{2}{3}$
3d year	21,000	3,000	180,000	1,260,000	1.66 $\frac{2}{3}$
4th year	18,000	6,000	360,000	1,080,000	1.66 $\frac{2}{3}$
5th year	12,000	6,000	360,000	720,000	1.66 $\frac{2}{3}$
6th year	6,000	6,000	360,000	360,000	1.66 $\frac{2}{3}$
	-----	27,000	1,620,000	-----	-----

the cost of the particular equipment used at that well.⁹ By applying an average rate of depreciation to the equipment of all the wells, the lesser amount of depreciation taken during the early years than would have been taken had the reserves of each well been computed separately is exactly compensated for in later years by the greater amount of depreciation taken than would have been taken had reserves of each well been separately computed.

Thus taxpayer, having chosen to treat all of the wells on an entire leasehold as a single economic unit, should not now be permitted to abandon that method and distort its income for a particular year by taking loss deductions as parts of that unit are retired. Cf. *Pacific National Co. v. Welch*, 304 U. S. 191; *St. Paul Union Depot Co. v. Commissioner*, 123 F. 2d 235 (C. C. A. 8th). As long as the economic unit is still producing oil, taxpayer suffers no loss from the retirement of a particular well. It will through depreciation allowances be fully compensated for the total cost of its entire investment in that unit, when the last barrel of oil is extracted. In short, the method adopted by taxpayer is predicated upon precisely the same principle as the situation where a composite rate of depreciation based on the average lives of a group of assets is used. See *U. S. Industrial Alcohol Co. v. Commissioner*, *supra*. In both instances the method

⁹ If the reserves of each well were computed separately, the equipment of those wells containing smaller estimated reserves (and which would therefore normally be retired before those with larger reserves) would be depreciated at a larger unit rate of depreciation.

adopted employs a rate which represents an average of the rates which would have been adopted had each asset been treated separately. In both instances the method adopted contemplates that some of the assets will normally be retired before and after the median factor upon which the rate was computed, and in both instances the method adopted will, by the time the last asset in the unit is retired, have returned to the taxpayer through depreciation allowances the full cost of its investment in all of the assets. In neither case, therefore, should a loss claimed for normal retirement in order to increase the amount of deductions for a particular year be permitted to thus distort income for that year as long as all the assets in the group have not been retired.¹⁰

It is also significant to note that the estimated oil reserves used by the taxpayer in figuring its depreciation rate represented not the absolute maximum reserves which a particular oil field was estimated to contain, but on the contrary represented the considered judgment based on sound business policy of what taxpayer believed the entire field would probably produce. The estimate, rather than being the maximum

¹⁰ The Commissioner has here determined that the method of accounting employed by taxpayer will clearly reflect its income only if the loss claimed on the normal retirement of assets is not permitted. The Tax Court affirmed that determination. The interpretation of the statute and the practice adopted by the administrative board charged with the duty of enforcing the Act should not be interfered with unless clearly unlawful. *Lucas v. American Code Co.*, 280 U. S. 445, 449: "It is not the province of the court to weigh and determine the relative merits of systems of accounting." *Brown v. Helvering*, 291 U. S. 193, 205.

amount of oil that could be expected to be recovered, probably represents more nearly the minimum estimated reserves. But in any event it clearly represents no more than the *average* estimated reserves, that is, a figure approximately half way between the estimated minimum and the estimated maximum reserves. As a matter of fact, taxpayer's position would not be improved even if it had established (which it has not) that its original estimate of oil reserves was based upon what was thought to be the absolute maximum amount of oil that could possibly be produced from a particular field. For while such a method of determining the depreciation rate might at first blush seem comparable to that employed in *Illinois Pipe Line Co. v. Commissioner, supra*, where the maximum life of the longest lived asset was used as the basis for determining the depreciation rate, in this case, unlike in the *Pipe Line* case, the estimate of future oil reserves was constantly revised in the light of later experience to determine a new rate each year.¹¹ As the *Pipe Line* and *Alcohol* cases and applicable Treasury Regulations clearly illustrate, a loss deduction for the normal retirement of assets depreciated through composite rates should be permitted only in those instances where to refuse such deduction would mean

¹¹ Had the depreciation rate been originally computed on the basis of the absolute maximum estimated reserves which a particular field might contain, and such estimated reserves never subsequently scaled down to coincide ultimately with actual reserves, only then would the full cost of all the assets not be recovered through depreciation allowances when the last barrel of oil was extracted.

that when the last asset is fully depreciated the total cost of all the assets comprising the group will not have been recovered through depreciation allowances. Such a situation exists, as the Regulations recognize, only where the composite depreciation rate, computed on the life of the maximum lived asset in the group, is continually applied without variation or adjustment. Of necessity, such situation cannot exist, as previously pointed out in Example 3, where the factors upon the basis of which the depreciation rate is determined is consistently reconsidered and adjusted each year to accord with actual experience. In the instant case "A new depreciation rate was computed whenever additional wells or additional capital items were added to existing wells during a year, or when it became appropriate, because of production experience, to increase or decrease the estimate of the remaining recoverable barrels of oil from a particular lease." (Pet. Br. 10.) That is, the estimate of future oil reserves was "corrected from year to year as experience * * * [showed] it to be too high or low and corrected finally to the actual barrels of oil produced." (Pet. Br. 30.) But in the *Pipe Line* case the depreciation rate, having been originally determined on the basis of the longest lived asset in the group, "was never adjusted." (Pet. Br. 20.) In no way can it be said, as taxpayer contends, that "that mode of determination is in legal effect the same as that used by Petitioner." (Br. 20.) On the contrary, here, just as in the case of Example 3, *supra*,

and unlike the *Pipe Line* case, the constant readjustment of taxpayer's depreciation rate will permit it to recover through depreciation the full cost of its investment in all of its assets when the estimated oil reserve is recovered. No deduction for loss upon the normal retirement of assets is therefore necessary or proper.

Despite taxpayer's assertion that its method of depreciation "presupposes that all of the equipment will last the life of * * * the oil lease" (Br. 2), it seems manifest that this is not the case. Rather it seems clear that it was contemplated that some of the wells would cease production before all of the oil from the entire field was recovered. Far from it being unusual that some of the wells should cease production before all the oil was recovered, it would on the contrary be most unusual if all the wells continued production up until the precise moment when the last barrel of oil to be recovered was finally extracted. As the Tax Court pointed out, "The fallacy of petitioner's argument lies in the fact that it presupposes the life of the tangible equipment of a well to be coextensive with the life of the lease or so long as the lease on which the wells are located is productive." (R. 78-79.) Just as in the case where a composite depreciation rate based on the average lives of a group of assets contemplates a normal retirement of assets both before and after the average life has been reached, so here the use of an average composite rate of depreciation based upon the combined oil reserves and total

cost of all the equipment applicable to a particular leasehold does likewise.¹²

3. Moreover, as the Tax Court recognized, apart from any other considerations, taxpayer's claimed deduction must be denied here since there is absolutely nothing in the record to indicate that the well equipment in question had actually become worthless during the taxable years. Since losses are allowable only on closed and completed transactions, no deduction for a claimed loss will be permitted unless it is clear that the property in question has in fact become worthless during the year the loss is claimed. *Lucas v. American Code Co.*, 280 U. S. 445; *United States v. White Dental Co.*, 274 U. S. 398; *Lambert v. Commissioner*, 108 F. 2d 624 (C. C. A. 10th); *De Loss v. Commissioner*, 28 F. 2d 803 (C. C. A. 2d), certiorari denied, 279 U. S. 840. Treasury Regulations 94, Article 23 (e)-3. Despite taxpayer's assertion to the contrary, the stipula-

¹² *Witherspoon Oil Co. v. Commissioner*, 34 B. T. A. 1130, relied on by taxpayer, apart from being distinguishable, as the Tax Court in the instant case pointed out, on the ground that the deduction claimed for the undepreciated cost of the assets involved was never questioned, is also distinguishable on another ground. In that case the years in controversy were 1924 to 1926, inclusive. The Regulations applicable to those years, Article 143 of Treasury Regulations 65 and 69, contained no prohibition against the deduction of losses claimed on the normal retirement of assets to which an average composite rate of depreciation is applied. The prohibition first appeared in Article 23 (e)-3 of Regulations 86, promulgated under the Revenue Act of 1934. This article was amended by T. D. 4612, XIV-2 Cum. Bull. 99, approved December 11, 1935, and as thus amended has been repeated in Article 23 (e)-3 of Regulations 94, 101 and Section 19.23 (e)-3 of Regulations 103. See also Mim. 4170, XII-1 Cum. Bull. 59, 61-62 (1934); Mim. 4170 (Rev.), XV-2 Cum. Bull. 148, 150-151 (1936).

tion between the parties did not declare that the "well equipment" had been abandoned because of its economic worthlessness. The stipulation merely shows that certain wells "became nonproductive and were abandoned. (R. 50.) But clearly there is nothing in the nature of oil well equipment which necessarily renders it permanently worthless simply because a particular well at which the equipment is being used proves unproductive. As the Tax Court observed in pointing out that the well equipment itself might be, and often is, available for use at other wells (R. 79):

The fact that a well becomes nonproductive and is abandoned does not necessarily result in the complete loss of usefulness of the equipment thereon or accelerate its depreciation or constitute abnormal retirement of the equipment. Such equipment may be and often is used at other wells. The stipulation shows that the wells involved were abandoned, but there is no evidence showing that the equipment thereon was also abandoned because it had lost its usefulness or that the abandonment of the wells caused depreciation of the equipment in excess of that normally sustained. Except that the stipulation shows that petitioner "wrote off" the amounts of \$5,044.13 and \$35,026.52 "as losses consequent to the abandonment of its" wells and claimed losses on its income tax returns in such amounts, there is no evidence that the equipment was actually retired or abandoned because it had lost its economic usefulness and had no more than scrap or salvage value or no value.

Nor is taxpayer's position improved by its complaint that it was unable to anticipate the Tax Court's decision

as to this point and was misled by the fact that the Commissioner had raised but one issue in his deficiency letter. (Br. 43.) Since deductions are a matter of legislative grace (*New Colonial Co. v. Helvering*, 292 U. S. 435, 440), before the Tax Court the burden is upon the taxpayer "to show that it was entitled to the deduction which the Commissioner had disallowed and that the additional tax was to that extent illegally assessed." *Reinecke v. Spalding*, 280 U. S. 227, 233; *Welch v. Helvering*, 290 U. S. 111. To sustain its burden taxpayer must establish every element of its claim by presenting a case that comes squarely within the terms of the statute. *New Colonial Co. v. Helvering*, *supra*; *White v. United States*, 305 U. S. 281, 292. As a corollary of this, it has been consistently held that the Tax Court is not bound by the reason assigned by the Commissioner in denying the deduction claimed. "If the disallowance is right it must be affirmed by the application of the correct rule of law" (*Acer Realty Co. v. Commissioner*, 132 F. 2d 512 (C. C. A. 8th), irrespective of the theory asserted by the Commissioner. See also *Helvering v. Gowran*, 302 U. S. 238; *Crowell v. Commissioner*, 62 F. 2d 51 (C. C. A. 6th); *Alexander Sprunt & Son v. Commissioner*, 64 F. 2d 424, 427 (C. C. A. 4th); *J. & O. Altschul Tobacco Co. v. Commissioner*, 42 F. 2d 609, 610 (C. C. A. 5th); *Standard Oil Co. v. Commissioner*, 43 B. T. A. 973, 998, affirmed, 129 F. 2d 363 (C. C. A. 7th). Having failed to sustain the burden of proving that the well equipment in question actually became permanently worthless during the taxable year, taxpayer's claim for a loss deduction must be denied.

II

The Tax Court has no jurisdiction to apply under the principle of recoupment, an overpayment of tax in a year where no deficiency has been found by the Commissioner against the deficiency in tax of the year before the Tax Court

Taxpayer also argues that even should this Court sustain the action of the Tax Court and deny the loss deductions claimed for the taxable years 1936 and 1937, it is, nevertheless, entitled to recoup against the deficiency for those years the sum of \$5,660.87, which sum represents the overpayment of its taxes for the year 1938, and which it is barred by the statute of limitations from recovering in any refund action. Taxpayer's claim for recoupment is predicated upon its assertion that the \$5,660.87 overpayment for the year 1938 was occasioned by, and is the result of, the Commissioner's disallowing the loss deductions claimed for 1936 and 1937, the taxable years in controversy. Taxpayer, in pressing the doctrine of equitable recoupment, relies primarily upon the decision of the Circuit Court of Appeals for the Eighth Circuit in *Gooch Milling & Elevator Co. v. Commissioner*, 133 F. 2d 131.¹³ Petition for a writ of certiorari has been

¹³ The basis of the decision in the *Gooch Milling Company* case, as the court there pointed out, was that the same fact, i. e., the inventory adjustment, which established a deficiency for the year in controversy automatically established an overpayment for the year sought to be offset against that deficiency. While taxpayer, in relying upon that decision, alleges that the \$5,660.87 overpayment in its taxes for the year 1938 was occasioned solely as the result of the Commissioner's disallowing the loss deductions here in issue for the taxable years 1936 and 1937, the facts do not appear to support this assertion. The record reveals that the overpay-

filed by the Government in the *Gooch Milling Company* case, and to the extent that that decision may be applicable here, we respectfully submit that it was incorrectly decided.

The only taxable years before the Tax Court in the instant case were the fiscal years ended September 30, 1936, and 1937. The taxable year ended September 30, 1938, is not here involved. Under these circumstances the taxpayer invokes the doctrine of equitable recoupment in an attempt to have the Tax Court determine an overpayment of tax for the fiscal year 1938, a year not before the Tax Court for determination, and to offset that overpayment against deficiencies in tax for the fiscal years ended September 30, 1936, and 1937, in an appeal properly before the Tax Court.

The Tax Court¹⁴ is a tribunal whose jurisdiction is limited by statute to the taxable year in which a

ment of \$5,660.87 for the year 1938 was due to taxpayer's reporting a capital gain realized from the sale of certain of its assets at a figure of \$134,453.89 in excess of the true capital gain. (R. 27.) Included in this total adjustment of \$134,453.89 were the amounts of \$5,044.13 and \$35,026.52, resulting from the disallowance of the loss deductions here in controversy. (R. 29-30.) It seems clear, therefore, that the \$5,660.87 overpayment for 1938 was due *only in part* to the Commissioner's disallowance of the loss deductions claimed here. To the extent of \$94,383.94 (\$134,453.89 - \$5,044.13 - \$35,026.52) taxpayer's income for 1938 was reduced as the result of adjustments in no way related to the loss deductions involved in the instant case. To the extent, therefore, that the overpayment of \$5,660.87 was due to the adjustment of taxpayer's income for 1938 in the amount of \$94,383.94, the decision in the *Gooch Milling Company* case can have no application here.

¹⁴ The name of the Board of Tax Appeals was changed to The Tax Court of the United States, effective October 22, 1942, by Section 504 (a) of the Revenue Act of 1942, Public Law 753, 77th

notice of deficiency in tax has been mailed by the Commissioner and a petition has been filed by the taxpayer with the Tax Court. Section 272 (a) of the Revenue Act of 1936 (Appendix, *infra*); *U. S. ex rel. Girard Co. v. Helvering*, 301 U. S. 540, 542. The Tax Court may determine an overpayment in tax only in respect of a taxable year in which the Commissioner has determined a deficiency in tax. *U. S. ex rel. Girard Co. v. Helvering*, *supra*; *Morrison Woolen Co. v. Commissioner*, 10 B. T. A. 8, 9; *Stanfield v. Commissioner*, 8 B. T. A. 787, 819. The Tax Court has no jurisdiction unless a deficiency in tax is found by the Commissioner. Section 322 (d) of the Revenue Act of 1936 (Appendix, *infra*). The Board in redetermining a deficiency in respect of any taxable year is authorized to consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, "but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid." Section 272 (g) of the Revenue Act of 1936 (Appendix, *infra*); *Commissioner v. Forest Glen C. Co.*, 98 F. 2d 968 (C. C. A. 7th), certiorari denied, 306 U. S. 639; *Greenleaf Textile Corp. v. Commissioner*, 26 B. T. A. 737, affirmed, 65 F. 2d 1017 (C. C. A. 2d).

Cong., 2d Sess., amending Section 1100 of the Internal Revenue Code. But Section 504 (b) of the Revenue Act of 1942 provided that the jurisdiction powers and duties shall be the same as provided by existing law in the case of the Board of Tax Appeals. See H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 172-173; H. Conference Rep. No. 2586, 77th Cong., 2d Sess., p. 40.

The decision of the Supreme Court in *U. S. ex rel. Girard Co. v. Helvering*, 301 U. S. 540, recognizes that the Board of Tax Appeals does not have jurisdiction to allow a recoupment as taxpayer here contends. The Supreme Court there held that the Board was without jurisdiction to order a refund or credit of overpayment of taxes, but rather was limited to the determination of the amount of the deficiency or overpayment upon the petition of the taxpayer to review a deficiency in tax found by the Commissioner. In point also is *Commissioner v. Forest Glen C. Co.*, 98 F. 2d 968 (C. C. A. 7th), certiorari denied, 306 U. S. 639, in which it was held that where the Commissioner had determined a deficiency in tax for one taxable year, the Board on appeal to it from such determination lacked jurisdiction to determine the tax for another taxable year.

In *Gooch Milling & Elevator Co. v. Commissioner*, *supra*, the majority of the court, in holding that the Board's jurisdiction extend to the case of an overpayment of a tax for one year when the taxpayer was contesting before the Board a deficiency covering a different year, ran counter not only to the decisional authority but also to the unambiguous terms of the statute. While the majority of the court in that case paid lip service to the express statutory prohibition that the Board of Tax Appeals shall have no jurisdiction to determine whether or not the tax for any taxable year, other than the year for which it is re-determining an asserted deficiency, has been overpaid or underpaid, it nevertheless directed the Board to offset the deficiency for the year before it by the amount by which the taxpayer had overpaid its taxes

for another year. We submit that since the Tax Court's jurisdiction extends only to the year for which a deficiency has been asserted by the Commissioner, the decision of the majority of the court in the *Gooch Milling Company* case is incorrect and that the Tax Court has no jurisdiction to allow recoupment of taxes paid for another year, regardless of any particular circumstances relating to such taxes or whether or not the overpayment of such taxes is admitted.

CONCLUSION

The decision of the Tax Court is correct and should be affirmed. The deficiency resulting should not be reduced by permitting recoupment for taxes paid for a year not before the Tax Court.

Respectfully submitted.

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MAY 1943.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(e) *Losses by individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

(f) *Losses by corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * *

SEC. 272. PROCEDURE IN GENERAL.

(a) *Petition to Board of Tax Appeals.*—If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this title, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within ninety days after such notice is mailed (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day), the taxpayer may file a petition with the Board of

Tax Appeals for a redetermination of the deficiency. * * *

* * * *

(g) *Jurisdiction over other taxable years.*—The Board in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

* * * *

SEC. 322. REFUNDS AND CREDITS.

* * * *

(d) *Overpayment found by Board.*—If the Board finds that there is no deficiency and further finds that the taxpayer has made an overpayment of tax in respect of the taxable year in respect of which the Commissioner determined the deficiency, the Board shall have jurisdiction to determine the amount of such overpayment, and such amount shall, when the decision of the Board has become final, be credited or refunded to the taxpayer. No such credit or refund shall be made of any portion of the tax unless the Board determines as part of its decision that it was paid within three years before the filing of the claim or the filing of the petition, whichever is earlier.

* * * *

Revenue Act of 1942, Public Law No. 753, 77th Cong., 2d Sess.:

SEC. 504. CHANGE OF NAME OF BOARD OF TAX APPEALS.

(a) *The Tax Court of the United States.*—Effective on the day after the date of enactment of this Act, section 1100 (relating to status of Board of Tax Appeals) is amended by inserting at the end thereof the following new sentence:

“The Board shall be known as The Tax Court of the United States and the members thereof shall be known as the presiding judge and the judges of The Tax Court of the United States.”

(b) *Powers, tenure, etc., unchanged.*—The jurisdiction, powers, and duties of The Tax Court of the United States, its divisions and its officers and employees, and their appointment, including the designation of its officers, and the immunities, tenure of office, powers, duties, rights, and privileges of the presiding judge and judges of The Tax Court of the United States shall be the same as by existing law provided in the case of the Board of Tax Appeals. * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 23 (e)-3. *Loss of useful value.*—When, through some change in business conditions, the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in such business, he may claim as a loss for the year in which he takes such action the difference between the basis (adjusted as provided in section 113 (b) and articles 113 (a) (14)-1, 113 (b)-1, and 113 (b)-2) and the salvage value of the property. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property has been prematurely discarded, as, for example, where an increase in the cost or change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allow-

ances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be fully explained in the return of income. The limitations provided in section 117 with respect to the sale or exchange of capital assets have no application to losses due to the discarding of capital assets.

If the depreciable assets of a taxpayer consist of more than one item and depreciation, whether in respect of items or groups of items, is based upon the average lives of such assets, losses claimed on the normal retirement of such assets are not allowable inasmuch as the use of an average rate contemplates a normal retirement of assets both before and after the average life has been reached and there is, therefore, no possibility of ascertaining any actual loss under such circumstances until all assets contained in the group have been retired. In order to account properly for such retirement the entire cost or other basis of assets retired, adjusted for salvage, will be charged to the depreciation reserve account, which will enable the full cost or other basis of the property to be recovered.

In cases in which depreciable property is disposed of due to causes other than exhaustion, wear and tear, and normal obsolescence, such as casualty, obsolescence other than normal, or sale, a deduction for the difference between the basis of the property (adjusted as provided in section 113 (b) and articles 113 (a) (14)-1, 113 (b)-1, and 113 (b)-2) and its salvage value and/or amount realized upon its disposition may be allowed subject to the limitations provided in the Act upon deductions for losses, but only if it is clearly evident that such disposition was not contemplated in the rate of depreciation.

In the case of classified accounts, if it is the consistent practice of the taxpayer to base the rate of depreciation on the expected life of the longest lived asset contained in the account, or in the case of single item accounts if the rate of depreciation is based on the maximum expected life of the asset, a deduction for the basis of the asset (adjusted as provided in Section 113 (b) and articles 113 (a) (14)-1, 113 (b)-1, and 113 (b)-2) less its salvage value is allowable upon its retirement. (See articles 23 (1)-1 to 23 (1)-10.)

Art. 23 (f)-1. *Losses by corporations.*— Losses sustained by domestic corporations during the taxable year and not compensated for by insurance or otherwise are deductible except in so far as not prohibited or limited by sections 23 (g), 24 (a) (6), 112, 117, 118, and 251. The provisions of articles 23 (e)-1, 23 (e)-2, 23 (e)-3, 23 (e)-4, 23 (e)-5, and 23 (h)-1 are in general applicable to corporations as well as individuals. See section 232 as to deductions by foreign corporations.

No. 10,373

IN THE
United States Circuit Court of Appeals
For the Ninth Circuit

MOHAWK PETROLEUM COMPANY (a California corporation), EDWIN V. McKENZIE, as Executor of the Estate of Alfred L. Marsten, Deceased, EDWIN V. McKENZIE, ALFRED L. MARSTEN, JR., and LEWIS A. MARSTEN,

Petitioners,

VS.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Upon Petition to Review Decisions of the Tax Court
of the United States.

REPLY BRIEF OF PETITIONERS.

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Subject Index

	Page
A. The main issue	1
B. The mistaken assumption of the Tax Court of the United States	15
C. Equitable recoupment	23
D. The text writers	27
E. Conclusion	29

Table of Authorities Cited

Cases	Pages
Commissioner v. Wright, 47 Fed. (2d) 871 (C.C.A. 7th)...	21
Eau Claire Book & Stationery Co. v. Commissioner, 65 Fed. (2d) 125 (C.C.A. 7th, May 25, 1933).....	21
Gooch Milling and Elevator Co. v. Commissioner, 133 F. (2d) 131	23
Illinois Pipeline Co., 37 B. T. A. 1070.....	5, 11, 13, 15, 30
Mason City Brick and Tile Co. v. Huston, 36 Fed. Supp. 515	30
Newell v. Commissioner of Internal Revenue, 66 Fed. (2d) 102	21
Underwood v. Commissioner of Internal Revenue, 56 Fed. (2d) 67	22
U. S. Industrial Alcohol Co., 42 B. T. A. 1323....	3, 6, 9, 10, 11, 30
Wyoming Investment Co., Ltd. v. Commissioner, 70 Fed. (2d) 191, 13 Amer. Fed. Tax Repts. 948 (10th Cir., March 26, 1934)	20

Miscellaneous

Alexander Publishing Company (111 Wall Street, New York City) from the "Alexander Tax News Letter", Nov. 6, 1942	27, 29
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REPLY BRIEF OF PETITIONERS.

A. THE MAIN ISSUE.

Respondent declares: "As long as the economic unit is still producing oil taxpayer suffers no loss from the retirement of a particular well. It will be, through depreciation allowances, fully compensated for the total cost of its entire investment in that unit when the last barrel of oil is extracted". (Res. Br. p. 25.)

(NOTE): All italics supplied by petitioner.

Among the petitioners are transferees who, by virtue of such status, are liable for this tax. Mohawk Petroleum Company, after the sale of all of its assets in 1938, dissolved, and distributed its assets to its stockholders, the transferee petitioners herein. It is clearly evident that unless the petitioners prevail in the instant proceeding they can never recoup the losses sustained on abandonment, because certainly no abandoned property was sold by the Petitioner to its successor, nor could such abandoned property have measured the price that Mohawk received on such sale.

Any statement, therefore, that these petitioners will be fully compensated for these sustained losses in the future is predicated on an erroneous assumption. But even if this were not true, even if the wells were still owned by Mohawk and continued to produce, the statement of Respondent would constitute no sufficient answer. One of the fundamental questions in the whole subject of income tax law is summed up in the single word "When": When does an item become income; when does an item become deductible? It is of almost the same importance as "Is this item income?", and "Is this item deductible?".

A yearly or any other period is arbitrary in an accounting sense. Tax law requires that income and deductions be fitted into an inelastic period of time, thus often resulting in manifest unfairness either to the Government or the taxpayer. To deny a loss actually sustained, when sustained, and justify it upon the assumption that later it will be recouped by the taxpayer through a depreciation account and thus make it chargeable, by a fiction, against a non-existent physical thing, is to deny

the time concept of money and to argue that money payable in a remote future is equal to money due today. And, further, it distorts the income for the year when the loss was sustained. By failing to allow a deduction, a false income appears upon which a tax is paid. In effect, the Government states: "You pay on the income which you never received and we will give it back to you some time in the future, but our promise to return it to you is contingent on many other factors, one of which is that you retain ownership of the property until the last drop of oil is produced from these lands".

Respondent further states, that "the method adopted by taxpayer is predicated upon precisely the same principle as the situation where a composite rate of depreciation based on the average lives of a group of assets is used. (See *U. S. Industrial Alcohol Company v. Commissioner*, supra.)" (Res. Br. p. 25.)

It is asserted that "In both instances the method adopted employs a rate which represents an average of the rates which would have been adopted had each asset been treated separately". It is declared that "In both instances the method adopted contemplates that some of the assets will normally be retired before and after the median factor upon which the rate was computed, and in both instances the method adopted will, by the time the last asset in the unit is retired, have returned to the taxpayer through depreciation allowances the full cost of its investment in all of the assets. In neither case, therefore, should a loss claimed for normal retirement in order to increase the amount of deductions for a particular year be permitted to thus distort income for that

year as long as all the assets in the group have not been retired." (Res. Br. p. 26.)

This is a convenient method of argument, but wholly without support. We emphatically deny that the method adopted by the taxpayer is predicated upon the same principle as the situation where a composite rate of depreciation based on the average lives of a group of assets is used, or that the Alcohol Case so holds.

The Revenue Act provides that a corporation may deduct from income losses sustained on abandonment of assets less salvage value. This is without question. A regulation provides for methods of computing a composite, or average, depreciation.

Either or any method of average depreciation may be used *if* it operates to prevent a double recoupment of the capitalized asset to the taxpayer; one, an entire return through depreciation, and the other through abandonment, discard or obsolescence loss. But equally important is the converse of the rule. And, this is the principle for which petitioner most earnestly contends.

Where a composite depreciation method is consistently used by a taxpayer which does not return to the taxpayer more than the capitalized value less salvage, *then* both abandonment losses and depreciation write-offs are permissible to such aggregate value. And, the abandonment loss can be written off in the year sustained. "Losses sustained * * * during the taxable year * * * are deductible * * *" (Pet. Br. p. 7.)

Logically, how may such self-evident proposition be denied? It is only when to permit a taxpayer an aban-

donment loss would be an addition to a recovery of the full value by depreciation that a deduction for such loss is properly denied.

If a deduction is denied upon the loss of an article, and if it is replaced by another similar article, how would it be treated? Keep both in a capital account and depreciate both? Or, if the article lost is not replaced, nevertheless maintain it as a capital asset? Or, charge it to a reserve to recoup the loss, not in the year sustained, but in other years by depreciation?

A taxpayer using a composite rate should be allowed a loss if a change of conditions necessitates replacing any asset which has been in use. To require that the loss be charged to the reserve would be to defer a deduction beyond the date of actual loss, and the Treasury, clearly, intended under the legislation to allow such a loss immediately subject only to the rule of no double recoupment.

We quote the Board in the *Pipeline* case:

“The statute allows a taxpayer deductions for losses upon retirement of assets. It is of course proper to consider the method of computing depreciation and to see that double deductions do not result. There is in the present case no distortion of income resulting from double deductions in this connection. On the contrary, if the retirement losses are disallowed, the deduction for depreciation would have to be increased in order to reflect income correctly.”

Illinois Pipeline Co. (37 B. T. A. 1070, 1081).

Even where varying physical lives of several articles are used there are *two methods* of using such composite

base. Again we use the five articles example referred to in the *Alcohol* case. The two methods are shown in tables. (Pet. Op. Br. p. 17.)

In Example "D" the five articles, having a total cost of \$50.00, are depreciated on a three year average life of $33\frac{1}{3}\%$ with a full recoupment in three years. This must occur unless the \$50.00 base is reduced each year by one-fifth the value. As pointed out in the *Alcohol* decision: "Depreciation taken on the full original cost basis would exhaust the total investment at the end of three years, and no depreciation would be allowable after that time, even though some of the assets would, by hypothesis, remain in use during the fourth and fifth years. Thus, for almost half the time, the taxpayer would be deprived of an annual deduction for depreciation". (*U. S. Industrial Alcohol Co.*, 42 B. T. A. 1323, 1376.)

It is certain that the method used by petitioner has no slightest resemblance to such average method. The rate here is not "keyed" to such an average. The second method is shown by Example "E". (Pet. Op. Br. p. 17.) "The cost basis is reduced as one of the assets is removed from the group by reason of normal retirement" (the "A" article of 1 year life) "* * * the gradually diminishing base and hence the reduced amount of depreciation" (as distinguished from the rate of depreciation) "will enable the taxpayer to continue to depreciate the assets remaining in each year at the composite rate throughout the fifth year, and the result will be an exact recovery at that time of the original cost of all the assets". *Alcohol* case, page 1376.

In Example "E" there has been an allowable depreciation ($33\frac{1}{3} \times \$50$) of \$16.67, and there has been deducted from the base \$10.00 for the purpose of extending the three-year average on a constant base to a five-year average, on a diminishing base.

"It follows that, if an asset forming part of a group subject to a composite depreciation rate is retired because it has reached the end of its normal life" (meaning its normal life *computed* in arriving at the average) "only its elimination as the cause of additional deductions will avoid unnecessary, premature depreciation on the one hand or double deduction on the other." (Ibid. p. 1376.)

"* * * assets which are retired at the end of their normal life" (meaning their normal life *computed* in arriving at the average) "cannot be permitted to furnish *further* compensation by way of a deduction for loss on retirement, even though they may be retired in advance of the average life of the entire group" (meaning articles of one year life to and including article of two year life). "Their early retirement" (meaning earlier than the average but not meaning earlier than normal and computed life) "will be compensated for by depreciation taken after the average period" (3 years) "has passed". (Ibid. p. 1378.)

Thus the one year and the five year article have a joint life of six years, and an average life of three years. The two extra beyond the average years of the five year life article have been added to the one year article, so the conception is that both have a three year life.

To apply this reasoning to Example "E": No deduction for a loss would be permitted if we added to the an-

nual write-off the amount by which the *base* is diminished each year, to wit, the sum of \$10.00. Under such method, in each year there would be a dual write-off which, in the aggregate, would double the value of the five articles by way of recoupment to the taxpayer.

By Example EE:

	Loss <u>Deduction</u>	Amount of <u>Depreciation</u>	<u>Total</u>
1st Year	\$10	\$16.67	\$ 26.67
2nd “	10	13.33	23.33
3rd “	10	10.00	20.00
4th “	10	6.67	16.67
5th “	10	3.33	13.33
	<hr/>	<hr/>	<hr/>
Totals	\$50	\$50.00	\$100.00

There is, therefore, no possible question respecting the rule and its proper application that, under certain definite circumstances no deduction loss can be allowed if it serves to allow the taxpayer a double recovery or any amount beyond the total sum invested in such assets less salvage.

“Even stronger reasons require that there be no *excessive* compensation by permitting loss deductions upon *normal* retirements. Since a composite rate assumes that some assets will be retired before and some after the average, those reaching the end of their *expected* life, whether before or after the average do not result in any loss. And to permit any to

be taken would tend to cause double deduction even more certainly than would the failure to reduce the base.” [Ibid. p. 1377.)

But if four of the five articles expired at the end of one day, would it not be an absurdity to contend that no deductible loss occurred? Disregarding, in the calculation, the one day life of four articles, the taxpayer would sustain a loss of \$40.00 less salvage, and should be permitted the deduction. The remaining five year life article would be depreciated \$2.00 per year. (\$10 x 20%.)

“What has been said, however, applies only to normal retirements; and the converse of the statement is also true. If assets are removed from the group as a result of abnormal retirements resulting from unanticipated causes occurring before the end of the normal life attributed to such assets in arriving at the composite rate, the resulting loss is the proper ground for a deduction. Such losses are not to be compensated for by way of depreciation, Southland Coal Co., 16 B. T. A. 50, and if not permitted as deductions will prevent the final recovery of the entire original cost.” (*Alcohol* case, pp. 1378-1379.)

The Commissioner’s rejection of the abandonment loss was overruled in that decision; and the abandonment losses were, in fact, allowed the taxpayer by the Board.

We find, therefore, that in “physical life” average depreciation cases the test is: How was the average life determined? What is the computed normal life of each article in the average? It is only the *computed* normal life span which has fixed the average and the rate. If an article fails substantially to attain that *computed* nor-

mal, then a deduction for an earlier retirement is allowable.

To this point we have not clearly shown the effect of the distinction referable to the instant case. The showing is foundational to the distinction between "physical life" and "economic life" cases.

A *sine qua non* to an average extending over the life of the longest lived article (5 years in the example, and not the three year average which would cause premature recovery in that period by depreciation of the full sum invested) is that the base must be reduced.

Again quoting the *Alcohol* case, page 1377:

"The following statement in the case of Illinois Pipeline Co., *supra*, may at first glance appear to indicate the contrary: 'However, if the basis is reduced as assets are retired, the entire cost of the retired assets cannot be recovered unless the depreciated cost of the retired assets is allowed as a deduction at the time of their retirement'. This statement was undoubtedly correct as applied to the facts of that case."

So, it is beyond question that none of the assets in this case could have a longer useful economic life than the life of the oil lease. This life expectancy may be expressed as N years. There can be no question that neither the depreciation, the rate, nor the deductions have the slightest relation to the average physical lives of the separate assets.

"Thus the depreciation there, and the deductions, being calculated upon the maximum economic life of the entire plant, not the average life of separate

assets, the loss deductions were proper.” (*Alcohol* case, pp. 1377-1378.)

No question is raised by Respondent that the opinions in the *Alcohol* and *Pipeline* cases are not sound in law. The only contention is that because in the *Pipeline* case a twenty year life of an oilfield was assumed to arrive at the 5% rate and here the life of the field was not estimated in years, and the rate did fluctuate, there is such difference as to render the reasoning there applied inapplicable here.

We examine this contention. Reference is made to a statement by Respondent (Res. Br. p. 19), too lengthy to be quoted here. We set forth our precise contention on this issue: For simplicity we will disregard salvage and assume that in each instance it has been deducted.

The separate cost of the three wells is shown (Mohawk's books of account set out these separate costs) in the examples (Pet. Op. Br. p. 8), and the production on the same three wells appears. (Ibid. p. 9.) The aggregate of the separate costs is divided by the estimated potential reserves of oil with a resultant rate of 2.5 cents per barrel; the rate multiplied by the aggregate of the barrels produced equals the amount of depreciation taken.

To obtain the rate for the second year the reserves (computed at the beginning of the first year) must be lessened by the oil recovered ($1,620,000 - 81,000 = 1,539,000$ barrels). But assume that experience during the year has shown two factors; that the reserves were too high, and the engineer corrects the reserves from 1,539,000 barrels to 900,000 barrels. And, further that Well No. 1 has

been abandoned on the last day of the first year of its production. We had a capitalized cost of \$10,000, reduced by salvage to \$9,000, and depreciation of \$500 ($2.5¢ \times 20,000$ barrels) and a loss of \$8,500. We have not only lost the well equipment but also part of the oil reserves through water infiltration. Wells No. 2 and No. 3 produce, respectively, 20,000 and 40,000 barrels during the second year. We then take the net cost, after salvage deductions, of \$31,500, reduce it by depreciation previously taken in the first year of \$1,525 ($20,000 + 41,000 \times 2.5$) and use the remainder of \$29,975 as the net remaining value to compute the rate. Therefore, $29,975 \div 900,000$ barrels = 3.33 cents per barrel, the rate. The same method is used successively through the years. It is a certain and customary method. Each year's production is precisely measured to the depreciated value (less salvage) of the equipment used during that year to produce that year's production. It is not disputed that this method returns *only* the cost. The net amount recovered by the taxpayer for abandonment losses is never recovered the second time by depreciation. From the time of such loss the depreciation no longer operates against the amount thereof. The economic cost of the well is the amount of the oil it produced during its life.

We apply Respondent's theory to the same situation. The rate is computed against \$29,975 plus the deduction loss restored, $\$38,475 \div 900,000$, the corrected reserves, equals a rate of 4.275 cents per barrel. On the two remaining wells on both theories depreciation is computed:

1st example: $60,000 \times 3.33 = \$1,988$;

2nd example: $60,000 \times 4.27 = \$2,562$.

In the first instance, the loss is taken when it in fact occurs and reflects a proper deduction to determine true income. In the second instance, it is postponed to be ultimately and fully recovered only when the last well on the property produces the last barrel of oil, perhaps twenty years hence. And if the property is sold no part of the purchase price can be measured against the non-existent asset. Nor may the capital account truthfully reflect such item.

Now, how does this occur? How is it possible, while denying the loss, to still ultimately restore it throughout a long period of years? The answer is perfectly obvious. The rate is raised. It is, in an economic sense, a false and wholly unjustified raise of rate, an expedient to take from a taxpayer unlawfully his money, and promise to ultimately restore it over a long period of years. Something like this always occurs when statutes and regulations are narrowly and literally construed. It never happens when the broad principle underlying a law is the measure of construction.

We now apply the same expedient of a change of rate to the *Pipeline* case, using a hypothetical value: Assume a value of \$100,000 comprised of ten articles at \$10,000 each. At the end of the first year, four articles are lost through abandonment. We have, then, \$100,000 minus \$5,000 depreciation, equals \$95,000 undepreciated value. We have abandoned four articles each of a value of \$10,000 less depreciation taken of \$500 ($4 \times 9,500 = \$38,000$). We write off the loss, \$95,000—\$38,000, leaving a remaining value of \$57,000. To obtain the new rate we divide \$57,000 by

19 remaining years,—equals 5.26. ($\$57,000 \div 19 = \$3,000 = 5.26\%$.) Not only has the rate been changed, but the base as well.

If it be assumed that for some obscure reason the rate may not be changed from the initial 5%, then the base will have to be lowered. Where does that leave us? From the depreciated value of \$95,000.00 we deduct \$38,000.00, and have a balance of \$57,000.00 which, multiplied by the rate, equals \$3,000.00 per year. Therefore,

1 year's depreciation,	\$ 5,000.00
19 years' depreciation,	57,000.00
Abandonment loss	38,000.00
	<hr/>
	\$100,000.00

If the reasoning used here were applied to the Pipeline facts, what would the conclusion be? On the \$100,000.00 value straight line depreciation each year for twenty years would result in the return of capital. Both the rate and base remain the same. There is no diminishing base. The five per cent is computed always against the original cost. Any abandonment loss is recovered within the twenty year period. But the Tax Court held that *if* the basis is reduced as assets are retired (necessary in honest accounting?) the entire cost cannot be recovered unless the depreciated cost of the retired assets is allowed as a deduction at the time of their retirement. Of course this implies that if the rate is changed to offset the lowered base, then full recovery would result by depreciation.

It is clearly evident that if the retired articles are permitted to remain in the account the situation is identical in principle to this case. But the Tax Court refused, on

the soundest of reasoning to so conclude. The holding seems clear enough: that when articles are retired they must be eliminated from the base at the time of retirement.

And that which we said in opening is clearly applicable: It is, that none of the assets under those circumstances could have a useful life longer than the last barrel of oil produced, and since the rate was computed by a ratio of remaining unproduced oil to the cost of the equipment depreciated, such part of the assets having a shorter life measured by the last barrel of oil produced would be retired at a loss unless such shorter lived articles are permitted to remain in the account after retirement.

This was precisely the issue in the *Pipeline* case. There the amount of the loss could have remained in the account to be returned over a period of years through depreciation. The contention of Respondent there was rejected. The same contentions with the same result following thereon, ought to be summarily rejected, here.

B. THE MISTAKEN ASSUMPTION OF THE TAX COURT OF THE UNITED STATES.

The second contention raised by Respondent is:

That there is nothing in the record to indicate that the well equipment became permanently worthless and that such equipment might have been available for use elsewhere; that the taxpayer must affirmatively establish a case within the applicable statutes, and a failure to do so precludes the allowance irrespective of the theory asserted by the Commissioner in denying the deduction. (Res. Br. p. 11.)

In support of the conclusion, Respondent cites general authority that no deductions for claimed losses will be permitted unless it is clear that the property has in fact become worthless during the year the loss is claimed (Res. Br. p. 30) and quotes from the opinion of the Tax Court of the United States in the instant case. (Res. Br. p. 31.)

Elementary principles are quoted to the general effect that:

A. The taxpayer must show that it is entitled to the deduction; and

B. Establish every element to show a case "squarely within the terms of the statute".

C. That if the disallowance is right it must be affirmed by the application of the correct rule of law. * * * irrespective of the theory asserted by the Commissioner. (Res. Br. p. 32.)

These citations are the basis of Respondent's declaration: "Nor is the taxpayer's position improved by its complaint that it was unable to anticipate the Tax Court's decision as to this point and was misled by the fact that the Commissioner had raised but one issue in his deficiency letter". (Res. Br. pp. 31-32.)

Here we find squarely presented an issue. The question ought to be judged, not alone by those considerations affirmatively set forth by Respondent but by the failure to consider the argument based on soundly reasoned authority urged by Petitioner. This issue is an ancient one between a narrow, strained and highly technical construction on the one hand, and a broad, liberal construction on the other. One defeats and wholly ignores the simplest

principles of fairness and the other requires a decision on the merits of a controversy.

In oil accounting, where the option of writing off intangible drilling expense is exercised by the taxpayer, the only capital account set up on the books is "Wells Equipment". "Wells Equipment" is in fact the "oil well" and represents the capitalized cost of that which is an integral physical part thereof. Against this capitalized cost, that is, tangible as distinguished from intangible cost, is first deducted ten per cent salvage merely to compute depreciation. It is the consistent practice of the industry, which was followed by petitioner, to compute this amount as being fairly representative of the value of "Wells Equipment" remaining when both its physical life referable to its original use and its economic life in producing the available oil has terminated. Depreciation rates were applied to the capitalized value *less* the salvage value. But the ten per cent factor is merely used as a preliminary estimate to obtain a proper base against which to compute the depreciation. Actually the loss in respect to abandonments is not ten percent; it may be fifty or any other percentage. The remaining undepreciated cost may be wholly lost.

In the instant case on two of the wells there was no salvage (Red Ribbon #6 and McKeehan #1) and on the others the actual salvage was credited to the loss. (R. pp. 53-54.) On McKeehan Well No. 3, the "tangible equipment removed from the well" was \$1,479.75. That sum was credited to the cost of \$16,549.36 and the resulting loss was \$14,100.75. (The difference being previous depreciation.) On Earl Fruit Well No. 1, the "tangible

equipment removed from the well'' was \$2,204.92; that sum was credited to the cost of \$15,735.91 resulting in a loss of \$13,530.99. (R. 54.)

The position taken by Respondent in effect denies this simple proposition and seeks a wholly arbitrary and erroneous—in fact—construction of a stipulation entered into by the parties before the Tax Board. We used the term which is the greater (oil wells), and, being greater, necessarily includes the lesser (wells equipment), that which is an integral part, and incident thereto.

The Petitioner "wrote off" the "wells equipment" because the wells "became non-productive and were abandoned". (R. 50.) We quote the stipulation: "During the fiscal year ended September 30, 1937, petitioner wrote off as losses *consequent to the abandonment* of its McKeehan wells No. 1 and No. 3 and its Earl Fruit Company well No. 1, a total amount * * *" (R. 53.)

We call attention to the computation of these losses (R. 54) which clearly and directly refute Respondent's contention that the "wells equipment" was not abandoned, in fact, contemporaneously with the abandonment of the oil wells.

LOSS ON MCKEEHAN WELL No. 3.

Total cost of tangible equipment capitalized	\$16,542.36
Less salvage value of tangible equipment <i>removed</i> from well	1,479.75
	<hr/>
<i>Balance of equipment abandoned</i>	\$15,062.61
Less depreciation previously written off	961.88
	<hr/>
Loss on McKeehan well No. 3	\$14,100.73

LOSS ON EARL FRUIT COMPANY WELL No. 1.

Total cost of tangible equipment capitalized	\$15,735.91
Less salvage value of tangible equipment <i>removed</i> from well	2,204.92
	<hr/>
Balance	\$13,350.99
Depreciation previously written off	none

On Red Ribbon Ranch Well No. 6, “abandonment loss \$5,044.03” (R. 53); “Loss on McKeehan Well No. 1, \$7,394.80.

Can there be any possible question as to the true stipulation? It was agreed between the parties that:

A. The value of the equipment “removed from the well” was a definite fixed amount. (This is the only equipment that was or could be used thereafter.)

B. That the “balance of equipment abandoned” was a definite fixed amount. “During the fiscal year * * * *petitioner wrote off as losses consequent* to the abandonment * * *”. (R. 53.) The agreed fact that certain equipment was abandoned expressly negatives the contention the wells equipment had not been abandoned, only the oil wells.

We emphasize that there is no issue of fact between the Commissioner and the taxpayer. The Commissioner accepted the accounts as reflected in the entries; it was agreed that certain oil wells had been abandoned, that certain equipment was saved, removed from the well and “that the balance of the equipment” had been abandoned.

Respondent seeks a decision on the merest quibble. The decision of the Tax Board was a mere inadvertence.

Here, there is no inadvertence. With all facts known, the sham contention is maintained.

No answer is made to Petitioners' argument that to abandon an oil well is to lose the surface string and the water string under California law requiring wells to be abandoned under a statutory method. (Pet. Br. p. 42.) Likewise, no reference is made to that line of tax decisions, that cases should be determined on the merits and not by strained construction of either stipulated or proved facts and that if the fact be doubtful further proof can be offered on a remand. Here we maintain that no remand is necessary because the stipulation, fairly construed, clearly supports the claim of Petitioner. In our opening brief we merely cited these cases. Here we briefly quote them:

Wyoming Investment Co., Ltd. v. Commissioner, 70
Fed. (2d) 191, 13 Amer. Fed. Tax Repts. 948
(10th Circuit, March 26, 1934):

"The taxpayer therefore produced no evidence to sustain the contention that the loss occurred in 1927."

The holding:

"The investment company was no doubt misled by the Commissioner's attorneys * * * and the erroneous statement of the issue at the hearing. * * * We are persuaded that on rehearing, the investment company will probably be able to establish that such stock became worthless during 1927. If this be true, the deduction should be allowed. We conclude that the investment company should be given an opportunity to produce further evidence and accordingly the case is remanded to the Board for rehearing on the correct issue".

Eau Claire Book & Stationery Co. v. Commissioner,
65 Fed. (2d) 125 (C.C.A. 7th Circuit, May 25,
1933):

“Likewise, we are satisfied that it would be in the interest of justice and fairer to both parties, if the cause were remanded, with opportunity given to them to supply, if they wish (*Underwood v. Commissioner of Internal Revenue* (C.C.A.), 56 Fed. (2d) 67) further evidence as to the value of the property and the services rendered with the giving of the notes, which were cancelled when the bonds were delivered. Likewise, the date of the sale of the bonds by the taxpayer to its stockholders might well be established with greater certainty”.

Newell v. Commissioner of Internal Revenue, 66
Fed. (2d) 102:

“The evidence, however, is not sufficiently complete to warrant an attempt on our part to ascertain the amount of the company’s loss through the death of the deceased, nor to say with finality and a reassuring degree of accuracy what effect the modification in the early capacity of the corporation would have upon the fair market value of the common stock. We conclude it would be fairer to both parties, and in the interest of justice, to reverse the order of the Board * * * and remand the case with directions to gather further evidence and make further findings on the controverted issues”.

Commissioner v. Wright, 47 Fed. (2d) 871, at 872
(C.C.A. 7th):

“There was no evidence offered of its value at the time of surrender, and we deem it only fair that further opportunity be accorded the taxpayer for the

presentation of such evidence. Accordingly, the cause is remanded to the Board of Tax Appeals with direction to give opportunity for presenting evidence of the value of the stock at the time of the surrender.”

Underwood v. Commissioner of Internal Revenue,
56 Fed. (2d) 67, at 73:

“In addition, there is the well established rule that an appellate court has the power, without determining and disposing of a case, to remand it to the lower court for further proceedings if the case has been tried on a wrong theory, or the record is not in condition for the appellate court to decide the question presented with justice to all parties concerned. See *Finefrock v. Kenova Mine Car Co.* (C.C.A.), 22 F. (2d) 627, 634, and cases cited; also *Seufert Bros. Co. v. Lucas* (C.C.A.), 44 F. (2d) 528”.

Among others, Respondent asserts the following principle: If the disallowance is right it must be affirmed by the application of the correct rule of law * * * irrespective of the theory asserted by the Commissioner”. (Res. Br. p. 32.)

How does this save the situation? Factually, the Commissioner was right; so was the taxpayer. The “wells equipment” had been abandoned in part. There is no erroneous theory here. If on the main issue of law, it is held that petitioner is entitled to the abandonment loss, there can be no slightest question that the loss was in fact sustained.

C. EQUITABLE RECOUPMENT.

Respondent states that Petitioners' main reliance is the decision of the Circuit Court of Appeals for the Eighth Circuit, in *Gooch Milling and Elevator Co. v. Commissioner*, 133 F. (2d) 131; and, that the overpayment in 1938 was occasioned by, and is, the result of the Commissioner's disallowance of the loss deductions claimed in 1936 and 1937, the taxable years in controversy. (Res. Br. p. 33.)

Respondent announces that a petition for a writ of certiorari has been filed by the Government in the *Gooch* case and that, in any event, the decision, in so far as here applicable, was incorrectly decided. (Res. Br. pp. 33-34.) In support of this view it is asserted that the Tax Court had no jurisdiction to decide in respect to any tax year not the subject of a deficiency; that the Tax Court may determine an overpayment only in respect of a tax year in which the Commissioner has determined a deficiency in tax. (Res. Br. pp. 34-35.) Respondent contends that the *Gooch* decision is erroneous because contrary to decisional authority and to the express terms of the statute.

It will serve no purpose to review the conflicting viewpoints in respect to this question. In a detailed and exhaustive opinion the Circuit Court has set forth its basic reasoning for the decision. It is applicable here to the same extent as there. Again, it is the old question of construction, a narrow, technical one resulting in flagrant injustice, an unconsciously, immoral judgment; the other, a broad construction resulting in a decision on the legitimate issue grounded on abstract right and wrong. We briefly quote from the opinion:

“In *Dixie Margarine Company v. Commissioner*, 6 Cir., 115 F. 2d 445, 447, the Court upheld the power of the Board to allow a recoupment based on an overpayment of tax for a prior year, although right to sue to recover same was barred by the statute of limitations. In the course of the opinion it is said ‘in the present case, the claim for refund and the deficiency assessment had a common origin, namely, the erroneous application of the Oleomargarine Act to petitioner’s product, and petitioner’s claim is therefore available in recoupment.

‘The Board has no occasion to consider whether the statute of limitation affected the availability of petitioner’s claim in recoupment. We think it did not.’ The Board having failed to permit recoupment, its decision was reversed and the case remanded for further proceedings in accord with the views expressed by the Circuit Court of Appeals.

Respondent quotes that part of the above statute which contains the limitation on the power of the Board, but we think it important to observe that the statute specifically provides that the Board ‘in re-determining a deficiency in respect to any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency’. It should be considered as a whole and, if possible, all its provisions given effect. *Jones v. York County*, 8 Cir., 47 F. 2d 837. Unlimited power is vested in the Board to investigate and consider the facts with relation to the taxes of other taxable years in determining deficiencies of any particular year. The limitation is to the effect that the Board shall not ‘determine’ that the tax for any other taxable year has been overpaid or underpaid. Whatever facts

with relation to the taxes of other taxable years may be necessary in order to determine the amount of the deficiency may be considered.”

In a footnote (Res. Br. p. 33), Respondent computes the amount affected by the recoupment plea, and declares: “It seems clear, therefore, that the \$5,660.87 overpayment for 1938 was due *only in part* to the Commissioner’s disallowance of the loss deductions claimed here”. (Ibid. p. 34.)

In this calculation Respondent is in error, and we assume that counsel will admit same on argument if our explanation convinces.

Reference is made to “Adjustments to Net Income Fiscal Year Ended Sept. 30, 1938” (R. 26):

Net income as shown on return and upon which tax was paid.....	\$507,623.32
In the capital gain adjustment of \$134,453.89 (R. 27) was the reduction of capital gain on sale of oil wells due to increased depreciated net cost consequent to disallowance of abandonment basis in prior years of	
Red Ribbon Ranch #6, abandonment loss disallowed	\$ 5,044.13
McKeehan #3, abandonment loss disallowed	14,100.73
McKeehan #1, abandonment loss disallowed	7,394.80
Earl Fruit #1, abandonment loss disallowed	13,530.99
	<u>\$ 40,070.65</u>

Net income excluding all other net adjustments made by Commissioner (R. 29-30)	\$467,552.67
Computation of tax (see computation (R. 30)) as basis of this computation:	
Normal tax net income excluding other adjustments	\$467,552.67
Dividends received credit	7,208.00
	<hr/>
Normal tax net income.....	\$460,344.67
Tax computed on said net income	\$ 67,891.70
Amount assessed and paid on original return	73,902.30
	<hr/>
Overpayment due to reduction of capital gain consequent solely to disallowance of abandonment losses in 1936 and 1937.....	\$ 6,010.60
There were other adjustments of capital gains, both debits and credits, the net of which is reflected in the difference between	\$469,844.22
appearing in the record (R. 30) and the above amount used herein of net income reflecting only the abandonment loss items.....	467,552.67
	<hr/>
Difference	\$ 2,291.55
The tax thereon was.....	\$ 349.73
	<hr/> <hr/>

Conclusion:

From the refund amount due solely to abandonment losses	\$ 6,010.60
is deducted that which taxpayer owed due to the net of all other adjustments.....	349.73
	<hr/>
Leaving a net balance due taxpayer of.....	\$ 5,660.87
which is the amount set forth by Petitioner.	

D. THE TEXT WRITERS.

The several tax service organizations employ text writers to digest, analyze and comment on all decisions; these services are sold to attorneys and income tax consultants. They also publish advance letters reviewing these decisions. We quote herein one of these comments issued by the Alexander Publishing Company (111 Wall Street, New York City) from the "Alexander Tax News Letter":

"ABANDONMENT LOSS DENIED: CASE VERY DOUBTFUL: News Letter does not like to take 'time out' to be listing doubtful opinions, but there are so many lately against taxpayers that some of them simply must be listed. In a new Tax Board case, taxpayer had physical equipment in several oil wells on leased property. It depreciated such equipment on each well based on the number of units (barrels) that the entire lease was supposed to produce. Tax Board concludes that this is the same as taking a 'composite rate' of depreciation on all physical assets of the taxpayer. That, however, is not the point. Assuming that there has been a composite rate used for all the physical assets on the leased property, the Tax Board then concludes that the taxpayer may not take deductions for wells actually abandoned. In this case, the abandonment losses were substantial. The proposition, expressed in simpler language is this: Tax Board concludes that where a taxpayer is taking a composite rate of depreciation against any and all its assets, it may not deduct in any one year a special amount for abandonment. Board concludes that the depreciation rate allows for normal discards, hence no loss may be taken for them. Opinion appears entirely erroneous. (Mohawk Petroleum Co., 47 BTA No. 130, Alex. Par. 1801.600.)

COMMENT: In Feb. and Apr. 1934, Treasury issued *TD 4422* and *Mim. 4170* which thereafter required

more extensive proof from taxpayers as to depreciation actually deductible. Among other statements in the rulings was this: 'Losses claimed on the normal retirement of assets—are not allowable, as the use of an *average rate* contemplates the normal retirement of assets both before and after the average life has been reached'. *Art. 23(e)-3*, Regs. 94, contains exactly this language also. They appear wrong. A composite or average rate does not necessarily contemplate losses from discards as being included. According to the Treasury's assumption, if a 10% rate is being taken, then 9% is for actual wear and tear and 1% for retirements or abandonments. Not so. Depreciation is an issue of FACT, not LAW. It is up to the taxpayer to prove whether or not his composite rate includes an extra amount for retirements; it is not up to the Treasury to force such conclusion in all cases. However, the particular case seems to have gone entirely wrong in its reasoning. It quotes case of *U. S. Industrial Alcohol Co.*, 42 BTA 1323, as denying losses for abandonments, and this is the only authority cited. Strange to relate, the Industrial Alcohol case ACTUALLY ALLOWED ABANDONMENT LOSSES despite a composite rate. However, it is possible to go further; in *Illinois Pipe Line Co.*, 37 BTA 1070, taxpayer owned assets—cost \$18,000,000, which had been depreciated at composite rate of 5% since 1915; in 1929 and 1930 it discarded \$345,000 and \$70,000; both deductions allowed as losses on the theory that there was THAT MUCH LESS IN ASSET VALUES to depreciate after 1930. This case is not mentioned in new Tax Board case. In *Mason City Tile Brick Co.*, 36 F Supp 515, exactly similar conclusion was reached. Taxpayer had used composite rate but was allowed abandonment deduction. In new case, abandonment losses from wells were substantial. No question exists but that losses were deductible. All three cases

mentioned (*Industrial Alcohol, Illinois Pipe Line and Mason City*), allow losses where *composite rate used and discards are substantial*—and this is *exactly the situation in new case*)." (Tax Letter Nov. 6, 1942.)

E. CONCLUSION.

In conclusion: Whether more or less depreciation was taken, whether one or another method was used to ascertain the amount, becomes wholly immaterial on the abandonment of the asset; only the capitalized value, less salvage, and previous depreciation is returned to the taxpayer: If the depreciation was less, the loss would be greater, and the converse is true.

How may it be logically inferred that the loss of these producing oil wells were normal losses and their respective lives were used to "average" same with other wells on the several leases?

The abandoned wells never produced the amount of oil in conformance with their potentials. This is shown by the fact that the abandoned losses were very high compared to capitalized costs. The Red Ribbon Well had a cost of \$9,093.60, and the loss was \$4,049.47; McKeehan No. 1, a cost of \$22,304.17, and a loss of \$7,394.80; McKeehan No. 3, a cost of \$16,542.36, and a loss of \$14,100.73; and Earl Fruit No. 1, a cost of \$15,735.91, and a loss of \$13,530.99. So, it appears that the aggregate capitalized cost of the four wells was \$63,676.04

With depreciation of	\$19,920.72	
And abandonment loss of	40,070.65	
And salvage of	3,684.67	\$63,676.04.

If the Tax Court was correct in the *Alcohol* and *Pipeline* cases, and if the District Court was likewise correct in *Mason City Brick and Tile Co. v. Huston*, 36 Fed. Supp. 515, the Tax Court erred in the Mohawk case.

Dated, San Francisco,
June 23, 1943.

Respectfully submitted,

JACOB H. SAPIRO,

EDWIN V. McKENZIE,

Attorneys for all Petitioners.

No. 10412

United States
Circuit Court of Appeals

For the Ninth Circuit.

AMERICAN GENERAL INSURANCE COM-
PANY, a corporation,

Appellant,

vs.

L. L. BOOZE, FRANK L. VINCENT, an indivi-
dual, FRANK L. VINCENT, doing business
under the firm name and style of Vincent's
Dairy,

Appellees.

Transcript of Record

Upon Appeal from the District Court of the United States
for the Northern District of California,
Northern Division

FILED

SEP 14 1943

PAUL B. O'BRIEN

No. 10412

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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

	Page
Answer of Frank L. Vincent.....	12
Answer of L. L. Booze.....	10 //
Appeal:	
Certificate of Clerk to Transcript of Record on	21
Designation of Documents on.....	20
Designation of Documents on Appeal, Supplemental	30
Notice of	18
Notice of, Supplemental.....	28
Points and Authorities upon Which Appellant Intends to Rely on	23
Certificate of Clerk to Transcript of Record on Appeal	21
Complaint	2
Designation of Documents on Appeal.....	20
Supplemental	30
Judgment of Dismissal (Supplemental Transcript)	27

Minutes of Court—Feb. 25, 1943—Granting Motions to Dismiss	19
Motion to Dismiss of Defendant Frank L. Vin- cent	14
Motion to Dismiss of Defendant L. L. Booze..	16
Names and Addresses of Attorneys	1
Notice of Appeal	18
Supplemental	28
Order Granting Motions to Dismiss.....	19
Points and Authorities Upon Which Appellant Intends to Rely (CCA)	23
Supplemental Transcript of Record.....	25
Designation of Documents on Appeal.....	30
Judgment of Dismissal.....	27
Notice of Appeal.....	28

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In The District Court of the United States, Northern District of California, Northern Division

No. 4526

AMERICAN GENERAL INSURANCE COMPANY, a Corporation,

Appellant,

vs.

L. L. BOOZE, FRANK L. VINCENT, an individual, FRANK L. VINCENT, doing business under the firm name and style of Vincent's Dairy,

Appellees.

COMPLAINT

Comes now the plaintiff and for cause of action alleges:

I.

Plaintiff American General Insurance Company is a corporation duly organized under and by virtue of the laws of the State of Texas, and at all times herein mentioned was, and now is, a citizen of, and domiciled in, said State of Texas. Plaintiff is admitted to do business in the State of California by virtue of having complied with all of the laws, rules and regulations of said State of California for the admission of a foreign corporation.

II.

Plaintiff is unaware of the true names or capacities, whether individual, corporate, associate or otherwise, of defendants Doe One, Doe Two, Doe

Three, Doe Four, Doe Five and Doe Six, and therefore sues the said defendants by such fictitious names, and leave of court will be asked to amend this complaint to show their true names and capacities when the same have been ascertained.

III.

The defendants L. L. Booze, Frank L. Vincent, an individual, and Frank L. Vincent doing business under the firm name and style of Vincent's Dairy, are citizens of, and domiciled in, the State of California.

IV.

As a part of the insurance business which the plaintiff is authorized to conduct in the State of California is included that of issuing certain agreements known as "Insurance Policies", for the purpose of indemnifying persons named in said policies, and protecting them under the conditions set out in said policies, from legal liability arising in connection with the maintenance, operation and ownership and driving of motor vehicles. In that connection the plaintiff had issued its policy No. 131186 to the defendant, Frank L. Vincent, as the "named assured" for the policy [1*] year beginning May 22, 1941, and ending May 22, 1942, which policy covered a 1940 Dodge one-ton canopy truck, Motor No. T96-5704, for use in connection with a commercial retail milk delivery business operated by the defendant, Frank L. Vincent, under the name and style of Vincent's Dairy; a photo-

*Page numbering appearing at foot of page of original certified Transcript of Record.

static copy of said policy of insurance issued to defendant Frank L. Vincent, together with the amendatory endorsement thereto, is attached to this complaint and marked Exhibit "A" and incorporated herein by reference as though fully set forth within this paragraph.

V.

On or about the 1st day of August, 1941, the defendant, Frank L. Vincent, was driving the 1940 Dodge truck described in the policy when said truck was involved in an accident with a Pontiac automobile driven by one Ray White, at the intersection of Nineteenth Street and Broadway Street in the City of Chico, County of Butte, State of California. At the time of said accident one Vernon Booze, a minor of the age of approximately fourteen years and the son of the defendant, L. L. Booze, was riding in a standing position on a step located at the back end of said 1940 Dodge truck which was owned and being driven by the defendant, Frank L. Vincent, at said time. As a result of said accident said Vernon Booze received injuries and died on or about August 3, 1941.

VI.

Subsequent to the happening of said accident and on or about the 22nd day of July, 1942, there was filed in the Superior Court of the State of California in and for the County of Butte, case No. 18996 entitled "L. L. Booze, plaintiff, versus Frank Vincent, an individual, Frank Vincent doing business under the firm name and style of Vin-

cent's Dairy, et al, defendants." The Frank Vincent referred to in said action is the Frank L. Vincent included as a defendant in this case, and a copy of the summons and complaint in said state court action has been served upon the defendant Frank L. Vincent, sued therein as Frank Vincent, an individual, and Frank [2] Vincent doing business under the firm name and style of Vincent's Dairy.

It is alleged in said complaint that L. L. Booze was the natural father of Vernon Booze, deceased, who upon the date of his death was a minor of the age of fourteen years, and that said minor met his death as a result of the wilful misconduct of Frank Vincent. It is further alleged in said complaint that by reason of the manner in which said Frank Vincent drove, maintained and operated said truck, and by reason of the reckless disregard by Frank Vincent of the probable consequences and safety of the minor, Vernon Booze, who was riding on said truck at the request of and with the consent of Frank Vincent said minor sustained fatal injuries to his head which resulted in his death two or three days after August 1, 1941. It is further alleged in said complaint that L. L. Booze by reason of the conduct of Frank Vincent was deprived of the society, comfort, protection and support of his minor son, Vernon Booze, and it is alleged that L. L. Booze was compelled to incur indebtedness for funeral expenses in the sum of Three Hundred Forty Eight Dollars Sixty Eight Cents (\$348.68), doctor's bills in the sum of Seventy Five Dollars

(\$75.00) nurses' bills in the sum of Twenty Five Dollars and a bill for hospital services in the sum of Forty Nine Dollars Ninety Five Cents, (\$49.95). It is alleged that in addition to said special damages L. L. Booze by reason of the death of said Vernon Booze was generally damaged in the sum of Twenty Five Thousand Dollars (\$25,000.00).

The indemnifying contract or insurance policy issued by plaintiff to the defendant, Frank L. Vincent, as above set out, was in a principal sum to cover injuries or accident to one person, and was in double that sum to cover one accident, and said sum for one person was in excess of the sum of Three Thousand Dollars (\$3000.00) but was less than Twenty Five Thousand Dollars (\$25,000.00). Plaintiff, therefore, alleges that the amount of the controversy between the various defendants and itself herein is in excess of Three Thousand Dollars (\$3000.00). [3]

VII.

Plaintiff has notified defendant Frank L. Vincent that plaintiff will not assume responsibility either for the defense of any law suit brought against said Frank L. Vincent by anyone because of claims on behalf of said Vernon Booze or on behalf of the heirs of said Vernon Booze resulting from the above described accident, and plaintiff has refused to contribute anything to the settlement of said claims and has refused to assume the defense of the action above described filed in the Superior Court of the State of California in and for the County of Butte by L. L. Booze.

VIII.

There is an actual controversy existing between plaintiff and defendants herein relative to the question of whether or not the policy of indemnification or insurance of the plaintiff did or does cover any claims made by L. L. Booze or any other party in connection with the injury and death of the minor, Vernon Booze, so as to establish responsibility against the plaintiff because of said contract of insurance. It is contended by the plaintiff that the deceased, Vernon Booze, was at the time of the accident above described acting as an employee or apprentice of the defendant, Frank L. Vincent, within the course and scope of his employment, and that as such employee, the sole remedy of the defendant, L. L. Booze, for the death of his son, Vernon Booze, is under the provisions of the Workmen's Compensation Act of the State of California. It is further contended by plaintiff that said policy of insurance does not cover any claims made or actions brought on account of the injury and death of said employee, Vernon Booze, and that there is no obligation under said policy to defend the action above described now pending in the state court, or to pay any judgment that might be rendered in said action. Plaintiff contends that the sole responsibility for the defense of any claims brought in connection with the death of Vernon Booze rests with Frank L. Vincent or with his workmen's compensation insurance carrier, if any. On the other hand, the defendants, [4] L. L. Booze and Frank L. Vincent, contend that the deceased, Vernon Booze,

was not in the employ of Frank L. Vincent at the time of the accident and claim that the plaintiff is liable and responsible on said insurance contract not only to Frank L. Vincent to defend him, in the above described state action, but also to L. L. Booze for any judgment, if any there be, entered in his favor and against Frank L. Vincent upon said judgment becoming final.

IX.

Unless it is legally determined that the plaintiff is not obligated to defend the defendant, Frank L. Vincent, in the action brought against him by L. L. Booze, this plaintiff will be required to set up reserves as required by law, to cover and protect against the possibility of unsuccessful defense, and reserves for the preparation and defense of the case, including legal fees, investigation costs, witness fees and court costs a trial and in preparation for trial. The action of L. L. Booze in the Superior Court of the State of California in and for the County of Butte against the defendant Frank L. Vincent is limited to issues which will not determine the questions presented in this petition for declaratory relief. Plaintiff contends that it should not be obliged to defend said action or to expend large sums of money necessarily involved in such defense and also that it should not be required to wait until said action has been tried and a judgment entered before securing a legal determination of this plaintiff's liability, if any, to the parties to said cause in the state court. Unless the issues here

presented are legally determined at this time it will be necessary for this plaintiff to establish and maintain for a long period of time a cash reserve covering the claims made and the action filed and the expenditures with reference thereto which it must make for its own protection unless this legal determination is now made, and this plaintiff claims, therefore, that these expenses of maintaining said reserve and making said investigation and incurring further expenses in preparation of this legal defense by way of fees, etc., should not be imposed upon the plaintiff if plaintiff's policy does not cover claims connected with the death of said Vernon Booze. [5] It is, therefore, of great importance that the question presented should be decided at the earliest possible date.

X.

All of the issues involved in the state action are in no way connected with the issues involved in this controversy respecting the rights of the plaintiff and the defendants herein concerning the policy of indemnification issued by the plaintiff as above described. A determination of the issues raised herein will establish the rights of the parties hereto and will relieve this plaintiff from the uncertainty which exists and will continue to exist while the issues of this petition are undetermined. The determination of the controversy presented by this petition will avoid a multiplicity of suits and will minimize the expense and costs to this plaintiff and will facilitate the determination of the liability, if any, of the plaintiff under its contract of insurance.

American

General
Company

Insurance

HOUSTON, TEXAS

(A Stock Insurance Company doing business under the Company)

DECLARATIONS

Item 1. Name of the Insured

FRANK L. VINCENT

The Named Insured is

INDIVIDUAL

Address

ROUTE 2, BOX 2178, CHICO, CALIFORNIA

City

State

County

The automobile will be principally garaged and used in the above Town, County and State, unless otherwise specified herein

The occupation of the Named Insured is

DATA Laid

Employed by

SELF

Item 2. Policy Period: From the 22nd day of MAY

(If current month, give last day of month)

to the 22nd day of MAY

By 42

Item 3. The insurance afforded is only with respect to such and so many of the following coverages as are indicated by a specific premium charge or charges set opposite thereto. The limit of the Company's liability against each such coverage shall be as stated herein, subject to all of the terms of the policy having reference thereto.
(If listed as Actual Value Policy, insert words "Actual Cash Value" in lieu of amount of insurance.)

COVERAGES		Limits of Liability	Net Rates	PREMIUM AUTO 1	PREMIUM AUTO 2
A—Bodily Injury Liability	and subject to that limit for each person	\$ 10,000			
		\$ 20,000, each accident	X X	\$ 23.00	
B—Property Damage Liability		\$5,000.00	X X	\$ 9.00	
C—Comprehensive Cover (Excluding Collision)					
D—Fire, Lightning and Transportation					
E—Theft, Robbery and Pilferage					
Collision (If Used)		Actual Cash Value	X X		
Comprehensive Collision (If Used) (See Note)		(Deductible)	X X		
Charge for		as per endorsement attached			
Charge for		as per endorsement attached			
TOTAL PREMIUM				\$32.00	

END, END. ATT.

4. Description of the automobile and the facts respecting its purchase by Named Insured:

YEAR MODEL	TRADE NAME	TYPE OF BODY (GIVE TRUCK OR TRAILER)	SERIAL NUMBER AND MOTOR NUMBER	No. of Cyls. and Model	Factory List Price	Actual Cost To Insured Includ. Equipmt.	Particulars of Amount Paid for
40	DODGE	1 TON CANOPY	S 9285153 M T96-5704	Cyls. MD 21			Month Year
				Cyls.			
				Mod.			

Item 5. The automobile is fully paid for by the named insured and there is no lien, mortgage or other incumbrance thereon except as follows:

If purchased in a financed payment plan, the amount repaid is represented by order of \$ _____ made on date of final note is _____

Item 6. The purpose for which the automobile is to be used is COMMERCIAL (See Note on back of policy). Persons of use defined for the term "operator" and "insured" is defined as person, partnership, firm, company, association, trust, estate, or other legal entity, or individual, who is primarily in the business operation of the named insured as stated in "General Description" including the use of the automobile for personal, pleasure, family and other business purposes, or one of the purposes for the purpose stated in the policy.

Item 7. No automobile insurance has been cancelled by any Company during the past three years except as herein stated.

Item 8. The Named Insured is the sole owner of the automobile except as hereinafter stated.

This policy is made and intended to be subject to the provisions, exclusions, conditions and limitations set forth in this policy policy.

In witness whereof, this Company has executed and attested these statements; that this policy shall not be valid in any state except by a duly authorized representative of this Company.

CHICO, CALIFORNIA

Secretary

CHICO, CALIFORNIA

President

Witnessed at

May 19th

May

1941

W.S. REMONDIS

III

Agent

General
Company

HOUSTON, TEXAS

Address:

[illegible][illegible]Name + Police Period: From th 2nd day of MAY to the 2nd day of MAY. Estimated hours: _____[illegible]

shall be as stated herein, subject to all of the terms of the policy having reference thereto, and to the "Actual Cash Value," in lieu of amount of insurance.)

COVERAGE	Kind of accident	Rate	AUTO 1	AUTO 2	Rating
(If listed in Actual Value Policy, enter words and subject to rate paid for each person)					
A-Individual Injury Liability	10,000.00 each person	X	X	23.00	
B-Property Damage Liability	20,000.00 each accident	X	X	9.00	
C-Comprehensive Cover (Including Collisions)	15,000.00				
D-Fire, Lightning and Transportation					
E-Theft, Burglary and Riffraff	1,000.00				
F-Collision or Upset	1,000.00	X	X		

AMERICAN TOYOTA EXPEDITIONER—AUTOMOBILE POLICY

³ The word "automobile" wherever used shall include under Coverages A and B a trailer other than a trailer built, while used exclusively for general, pleasure or family purposes, other than business purposes, with any private passenger automobile limited liability coverage.

[illegible]

9. *Use of Other Private Passenger Automobiles.* Such insurance as is afforded by the policy for bodily injury liability and for property damage liability also applies subject to the following provisions:

3. The insurance applies:
 - (a) to the Named Insured, if an individual and the owner of the automobile classified as "pleasure and business" or if an individual and wife or both of whom own such automobile; and
 - (b) to the spouse of such individual if a resident of the same household and to the employees of the Named Insured, as insured.

with respect to the operation of any other private passenger automobile, by such Named Insured or spouse, or by a private passenger in the supply of either of them, and with respect to the insurance of such Named Insured or spouse in any other private passenger automobile.

[illegible]

3. The insurance shall be among insurances over any other valid and enforceable insurances available to the insured under a policy applicable with respect to the automobile or sublease, against a loss covered elsewhere.

Eus S. Northam

100

Neutrophilic leukocytosis

of the 1980s, the 1990s, and the 2000s. The 1980s were characterized by a strong emphasis on the environment, with a focus on reducing pollution and protecting natural resources. The 1990s saw a shift towards economic globalization and the rise of the Internet. The 2000s were marked by the September 11 attacks and the subsequent wars in Afghanistan and Iraq. The 2010s have been characterized by the rise of social media and the ongoing debate about climate change. The 2020s have been dominated by the COVID-19 pandemic and the ongoing debate about the future of the world.

agreement. The names of the directors and officers of the Company shall be kept confidential and shall not be disclosed to any person other than the Company's auditors, lawyers, accountants, investment bankers, and other persons who are necessary to the Company's business. The Company shall not be bound by any agreement, understanding or arrangement with any person which purports to restrict the Company's ability to enter into such an agreement, understanding or arrangement with any person.

LIMITS OF LIABILITY

FINANCIAL REPORTING
The SEC has issued a new rule that will require companies to disclose more information about their financial reporting practices. The rule is part of the SEC's ongoing effort to improve the transparency and reliability of financial reporting.

[illegible]

CONVULSIVE TENDENCY

[illegible]

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[illegible]

1

OPPORTUNITY. If you're looking for a new challenge, this is the place to be. The company is looking for individuals who are willing to take on the challenge of leading a team of professionals in a highly competitive market. The position offers a unique opportunity to work with some of the best talent in the industry and to make a significant impact on the company's success. If you're ready to take on the challenge, we want to hear from you. Send your resume and cover letter to [email address] for consideration.

100

[illegible]

554/555

ROBERT W. LAMB
is president of the American
Association of University
Professors, 1200 16th St.,
N.W., Washington, D.C. 20036.

1000

[illegible]

100

EXPERIENCE—I have 10 years of experience in the automotive industry. I have worked for a number of years for a major automotive manufacturer, and I have also worked for a number of years for a major automotive retailer. I have a strong background in sales, marketing, and customer service. I am a team player and I am always willing to learn and grow. I am confident that I can bring a lot of value to your company.

EDUCATION—I have a Bachelor's degree in Business Administration from the University of California, Los Angeles. I am currently pursuing my Master's degree in Business Administration from the University of California, Los Angeles.

SKILLS—I have a strong background in sales, marketing, and customer service. I am a team player and I am always willing to learn and grow. I am confident that I can bring a lot of value to your company.

REFERENCES—I have a number of references that I can provide. I am confident that they will speak to my qualifications and my ability to perform the job.

DISCUSSION

[illegible]

11

The *Journal of Aging Research* has been selected by the American Society on Aging to be included in its list of journals of interest to the field. The journal is published by the American Society on Aging, 1000 Pennsylvania Avenue, N.W., Washington, D.C. 20004.

1998, 1999, 2000, 2001, 2002, 2003, 2004, 2005, 2006, 2007, 2008, 2009, 2010, 2011, 2012, 2013, 2014, 2015, 2016, 2017, 2018, 2019, 2020, 2021, 2022, 2023, 2024, 2025, 2026, 2027, 2028, 2029, 2030, 2031, 2032, 2033, 2034, 2035, 2036, 2037, 2038, 2039, 2040, 2041, 2042, 2043, 2044, 2045, 2046, 2047, 2048, 2049, 2050, 2051, 2052, 2053, 2054, 2055, 2056, 2057, 2058, 2059, 2060, 2061, 2062, 2063, 2064, 2065, 2066, 2067, 2068, 2069, 2070, 2071, 2072, 2073, 2074, 2075, 2076, 2077, 2078, 2079, 2080, 2081, 2082, 2083, 2084, 2085, 2086, 2087, 2088, 2089, 2090, 2091, 2092, 2093, 2094, 2095, 2096, 2097, 2098, 2099, 2100, 2101, 2102, 2103, 2104, 2105, 2106, 2107, 2108, 2109, 2110, 2111, 2112, 2113, 2114, 2115, 2116, 2117, 2118, 2119, 2120, 2121, 2122, 2123, 2124, 2125, 2126, 2127, 2128, 2129, 2130, 2131, 2132, 2133, 2134, 2135, 2136, 2137, 2138, 2139, 2140, 2141, 2142, 2143, 2144, 2145, 2146, 2147, 2148, 2149, 2150, 2151, 2152, 2153, 2154, 2155, 2156, 2157, 2158, 2159, 2160, 2161, 2162, 2163, 2164, 2165, 2166, 2167, 2168, 2169, 2170, 2171, 2172, 2173, 2174, 2175, 2176, 2177, 2178, 2179, 2180, 2181, 2182, 2183, 2184, 2185, 2186, 2187, 2188, 2189, 2190, 2191, 2192, 2193, 2194, 2195, 2196, 2197, 2198, 2199, 2200, 2201, 2202, 2203, 2204, 2205, 2206, 2207, 2208, 2209, 2210, 2211, 2212, 2213, 2214, 2215, 2216, 2217, 2218, 2219, 2220, 2221, 2222, 2223, 2224, 2225, 2226, 2227, 2228, 2229, 2230, 2231, 2232, 2233, 2234, 2235, 2236, 2237, 2238, 2239, 2240, 2241, 2242, 2243, 2244, 2245, 2246, 2247, 2248, 2249, 2250, 2251, 2252, 2253, 2254, 2255, 2256, 2257, 2258, 2259, 2260, 2261, 2262, 2263, 2264, 2265, 2266, 2267, 2268, 2269, 2270, 2271, 2272, 2273, 2274, 2275, 2276, 2277, 2278, 2279, 2280, 2281, 2282, 2283, 2284, 2285, 2286, 2287, 2288, 2289, 2290, 2291, 2292, 2293, 2294, 2295, 2296, 2297, 2298, 2299, 2300, 2301, 2302, 2303, 2304, 2305, 2306, 2307, 2308, 2309, 2310, 2311, 2312, 2313, 2314, 2315, 2316, 2317, 2318, 2319, 2320, 2321, 2322, 2323, 2324, 2325, 2326, 2327, 2328, 2329, 2330, 2331, 2332, 2333, 2334, 2335, 2336, 2337, 2338, 2339, 2340, 2341, 2342, 2343, 2344, 2345, 2346, 2347, 2348, 2349, 2350, 2351, 2352, 2353, 2354, 2355, 2356, 2357, 2358, 2359, 2360, 2361, 2362, 2363, 2364, 2365, 2366, 2367, 2368, 2369, 2370, 2371, 2372, 2373, 2374, 2375, 2376, 2377, 2378, 2379, 2380, 2381, 2382, 2383, 2384, 2385, 2386, 2387, 2388, 2389, 2390, 2391, 2392, 2393, 2394, 2395, 2396, 2397, 2398, 2399, 2400, 2401, 2402, 2403, 2404, 2405, 2406, 2407, 2408, 2409, 2410, 2411, 2412, 2413, 2414, 2415, 2416, 2417, 2418, 2419, 2420, 2421, 2422, 2423, 2424, 2425, 2426, 2427, 2428, 2429, 2430, 2431, 2432, 2433, 2434, 2435, 2436, 2437, 2438, 2439, 2440, 2441, 2442, 2443, 2444, 2445, 2446, 2447, 2448, 2449, 2450, 2451, 2452, 2453, 2454, 2455, 2456, 2457, 2458, 2459, 2460, 2461, 2462, 2463, 2464, 2465, 2466, 2467, 2468, 2469, 2470, 2471, 2472, 2473, 2474, 2475, 2476, 2477, 2478, 2479, 2480, 2481, 2482, 2483, 2484, 2485, 2486, 2487, 2488, 2489, 2490, 2491, 2492, 2493, 2494, 2495, 2496, 2497, 2498, 2499, 2500, 2501, 2502, 2503, 2504, 2505, 2506, 2507, 2508, 2509, 2510, 2511, 2512, 2513, 2514, 2515, 2516, 2517, 2518, 2519, 2520, 2521, 2522, 2523, 2524, 2525, 2526, 2527, 2528, 2529, 2530, 2531, 2532, 2533, 2534, 2535, 2536, 2537, 2538, 2539, 2540, 2541, 2542, 2543, 2544, 2545, 2546, 2547, 2548, 2549, 2550, 2551, 2552, 2553, 2554, 2555, 2556, 2557, 2558, 2559, 2560, 2561, 2562, 2563, 2564, 2565, 2566, 2567, 2568, 2569, 2570, 2571, 2572, 2573, 2574, 2575, 2576, 2577, 2578, 2579, 2580, 2581, 2582, 2583, 2584, 2585, 2586, 2587, 2588, 2589, 2590, 2591, 2592, 2593, 2594, 2595, 2596, 2597, 2598, 2599, 2600, 2601, 2602, 2603, 2604, 2605, 2606, 2607, 2608, 2609, 2610, 2611, 2612, 2613, 2614, 2615, 2616, 2617, 2618, 2619, 2620, 2621, 2622, 2623, 2624, 2625, 2626, 2627, 2628, 2629, 2630, 2631, 2632, 2633, 2634, 2635, 2636, 2637, 2638, 2639, 2640, 2641, 2642, 2643, 2644, 2645, 2646, 2647, 2648, 2649, 2650, 2651, 2652, 2653, 2654, 2655, 2656, 2657, 2658, 2659, 2660, 2661, 2662, 2663, 2664, 2665, 2666, 2667, 2668, 2669, 2670, 2671, 2672, 2673, 2674, 2675, 2676, 2677, 2678, 2679, 26

[illegible]

Wherefore, plaintiff prays for a judgment and declaration of the rights and obligations of the parties hereto arising out of the matters herein alleged by having the court determine that the plaintiff is under no obligation, liability or responsibility either to defend the action brought in the Superior Court of the State of California, in and for the County of Butte, by L. L. Booze against Frank Vincent, an individual, and Frank Vincent doing business under the firm name and style of Vincent's Dairy, or to pay any judgment, if any there be, which may be entered in any event, in favor of said L. L. Booze and against said Frank Vincent, individually or otherwise. Plaintiff prays for such other and further relief as to the court may seem proper.

BETTS & GARRISON

By JOHN A. LOOMIS

Attorneys for Plaintiff

Attached is Exhibit "A" (photostatic copy of policy.)

[Endorsed]: Filed Aug 27 1942 [6]

Short Rate Cancellation Table

FOR THE TERM OF ONE YEAR

Percentage to be refunded on premium

Days in term	Percentage to be refunded on premium
1 day	2
2 days	3
3 days	4
4 days	5
5 days	6
6 days	7
7 days	8
8 days	9
9 days	10
10 days	11
11 days	12
12 days	13
13 days	14
14 days	15
15 days	16
16 days	17
17 days	18
18 days	19
19 days	20
20 days	21
21 days	22
22 days	23
23 days	24
24 days	25
25 days	26
26 days	27
27 days	28
28 days	29
29 days	30
30 days	31
31 days	32
32 days	33
33 days	34
34 days	35
35 days	36
36 days	37
37 days	38
38 days	39
39 days	40
40 days	41
41 days	42
42 days	43
43 days	44
44 days	45
45 days	46
46 days	47
47 days	48
48 days	49
49 days	50
50 days	51
51 days	52
52 days	53
53 days	54
54 days	55
55 days	56
56 days	57
57 days	58
58 days	59
59 days	60
60 days	61
61 days	62
62 days	63
63 days	64
64 days	65
65 days	66
66 days	67
67 days	68
68 days	69
69 days	70
70 days	71
71 days	72
72 days	73
73 days	74
74 days	75
75 days	76
76 days	77
77 days	78
78 days	79
79 days	80
80 days	81
81 days	82
82 days	83
83 days	84
84 days	85
85 days	86
86 days	87
87 days	88
88 days	89
89 days	90
90 days	91
91 days	92
92 days	93
93 days	94
94 days	95
95 days	96
96 days	97
97 days	98
98 days	99
99 days	100

For the percentage at the above table we are not making the change for 22 days shall be 100 and so on up to one year.

WHAT TO DO IN THE EVENT OF AN ACCIDENT

1. Obtain name and address of injured and where where other accident.

2. Obtain names, addresses and telephone numbers of ALL witnesses.

3. Do not express an opinion as to your responsibility for the accident. Remember that your policy covers only LEGAL liability and only a licensed insurance adjuster can determine that. Usually it's more costly if you are not insured by law to indemnify you for your damage.

4. If another car is involved in the accident, secure name and address of owner, make and license number of car, and if insured, the name of the insurance company.

5. Any accident, no matter how small, should be reported to the Agent where your license is on file.

6. In case of serious or fatal accident, give or telephone the available details, including policy number, to the General Agent where you are.

give below or to the Home Office of the Company.

GRAVENS, DARGAN & FOX
General Agents
1145 Sawyer Street
San Francisco, California

FOR HOME OFFICE USE ONLY
Canadian Policy
Can. Made Returned
Business Priv. Voided

A STOCK COMPANY
AUTOMOBILE COMBINATION POLICY
OPTIONAL COVERAGE FORM

NO. 131186

ISSUED TO

FRANK L. WILMONT

Premium - - - \$ 32.00

MAI 22nd 1942

GRAVENS, DARGAN & FOX
General Agents
SAN FRANCISCO, CALIFORNIA



Insurance Company
HOUSTON, TEXAS

PLEASE READ YOUR POLICY

Western Edition 1240

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J. W. CARLWITZ, Vice-President

[Title of Court and Cause.]

ANSWER OF DEFENDANT L. L. BOOZE

Comes now defendant, L. L. Booze, and answering the complaint of plaintiff on file herein by way of answer, alleges, admits and denies as follows, to-wit:

FIRST DEFENSE

The complaint fails to state a claim against defendant upon which relief can be granted.

SECOND DEFENSE

Defendant admits Paragraphs I, II, III and IV of said complaint.

Defendant admits Paragraph V of said complaint.

Defendant admits Paragraph VI of said complaint, excepting that defendant denies the last paragraph thereof, and alleges that the amount of the controversy between the various defendants and plaintiff is not in excess of Three Thousand and no/100 (\$3000.00) Dollars in that the amount of damages cannot be ascertained at this time.

Defendant denies Paragraph VII.

Answering Paragraph VIII, defendant alleges that the matters therein referred to are matters to be decided in the action in the complaint alleged to be now pending before the Superior Court of the County of Butte, State of California, and being Butte County No. 18996, and specifically referred to in Paragraph VI of said complaint, and that in said action last mentioned all of the issues involved herein as to the liability of the plaintiff will be determined, and there is another action involving

the issues involved herein, the Butte County action last referred to.

Answering Paragraph IX and X, defendant, L. L. Booze, incorporates by reference the answer made to Paragraph VIII above. [7]

Wherefore, answering defendant, L. L. Booze, prays as follows, to-wit:

1. That the above action be dismissed.

2. That plaintiff take nothing by its said action, but that the answering defendant, L. L. Booze, have judgment for his costs incurred herein.

J. OSCAR GOLDSTEIN and
JAMES WM. MORGAN

Attorneys for defendant, L.
L. Booze, 142 W. Second
St., Chico, California

[Endorsed]: Filed Sep 18 1942. [8]

[Title of Court and Cause.]

ANSWER OF DEFENDANTS FRANK L. VINCENT, AN INDIVIDUAL, AND FRANK L. VINCENT DOING BUSINESS UNDER THE FIRM NAME AND STYLE OF VINCENT'S DAIRY

Come now the defendants Frank L. Vincent, an individual, and Frank L. Vincent doing business under the firm name and style of Vincent's Dairy, and answering the complaint of plaintiff, for cause of answer allege, admit and deny as follows, to-wit:

FIRST DEFENSE

The complaint fails to state a claim against defendants upon which relief can be granted.

SECOND DEFENSE

Defendants admit paragraphs I, II, III and IV, of said complaint.

Defendants admit paragraph V of said complaint except they deny that the said Vernon Booze, a minor, referred to therein was riding in a standing position on a step located at the back end of the 1940 Dodge truck referred to therein.

Defendants admit paragraph VI, excepting that they deny the last paragraph thereof, and allege that the amount of the controversy between the various defendants and plaintiff is not in excess of Three Thousand Dollars (\$3000.00).

Defendants deny paragraph VII.

Answering paragraph VIII, the defendants allege that the matters therein referred to are matters to be decided in the action in the complaint alleged to be now pending before the Superior Court of the County of Butte, State of California, and being Butte [9] County No. 18996, and specifically referred to in paragraph VI of said complaint, and that in said action last mentioned all of the issues involved herein as to the liability of the plaintiff will be determined, and there is another action involving the issues involved herein, the Butte County action last referred to.

Wherefore, answering defendants pray as follows, to-wit:

1. That the above action be dismissed.
2. That plaintiff take nothing by its said action,

but that answering defendants have judgment for their costs incurred herein.

PETERS AND PETERS

Attorneys for Answering Defendants Frank L.

Vincent, an individual, and Frank L. Vincent doing business under the firm name and style of Vincent's Dairy 304 Broadway, Chico, California.

[Endorsed]: Filed Sep 16 1942. [10]

[Title of Court and Cause.]

MOTION TO DISMISS AND NOTICE OF
MOTION

The defendants move the Court as follows:

1. To dismiss the action because the complaint fails to state a claim against said defendants upon which relief can be granted.

2. To dismiss the action because the Court has no jurisdiction of the subject matter of this action inasmuch as the complaint on file herein to which is attached the policy of insurance issued by plaintiff to the defendant Frank L. Vincent discloses that it is merely a policy to pay any judgment that may be rendered against Frank L. Vincent and/or Frank L. Vincent doing business under the firm name and style of Vincent's Dairy, for personal injury caused by the operation of the 1940 Dodge one-ton canopy truck therein mentioned, and that no judgment has been rendered, and *therefor* no controversy can

be had thereover until such judgment be rendered, and *therefor* the controversy in question does not exceed the sum of Three Thousand Dollars (\$3000.00), and the Court is without the jurisdiction to entertain the same.

3. To dismiss the action upon the ground that there is another action pending involving the same issues involved in the present action, namely the action of "L. L. Booze, plaintiff, versus Frank Vincent, an individual, Frank Vincent doing business under the firm name and style of Vincent's Dairy, et al, defendants", which said action is pending in the Superior Court of the County of Butte, State of California, and is case No. 18996, all of which is [11] disclosed in the complaint of plaintiff on file herein, to which said complaint reference is hereby made, and which is incorporated herein, and made a part hereof.

PETERS AND PETERS

Attorneys for Answering Defendants Frank L. Vincent, an individual, and Frank L. Vincent doing business under the firm name and style of Vincent's Dairy, 304 Broadway, Chico, California.

To Betts and Garrison

Attorneys for Plaintiff

Please take notice that the undersigned will bring the above motion on for hearing before this Court in the Courtroom thereof in the Federal Building on "I" Street between Fifth Street and Sixth Street, in the City of Sacramento, County of Sac-

ramento, State of California, on Monday, the 19th day of October, 1942, at 10:00 o'clock in the forenoon of that day or as soon thereafter as counsel can be heard.

PETERS AND PETERS

Attorneys for defendants Frank L. Vincent, an individual, and Frank L. Vincent doing business under the firm name and style of Vincent's Dairy, 304 Broadway, Chico, California.

(Attached is Affidavit of Service by Mail)

[Endorsed]: Filed Sep 16 1942. [12]

[Title of Court and Cause.]

MOTION TO DISMISS AND NOTICE OF
MOTION

The defendant, L. L. Booze, move the Court as follows:

1. To dismiss the action because the complaint fails to state a claim against said defendants upon which relief can be granted.

2. To dismiss the action because the Court has no jurisdiction of the subject matter of this action inasmuch as the complaint on file herein to which is attached the policy of insurance issued by plaintiff to the defendant Frank L. Vincent discloses that it is merely a policy to pay any judgment that may be rendered against Frank L. Vincent and/or Frank L. Vincent doing business under the firm name and style of Vincent's Dairy, for personal

injury caused by the operation of the 1940 Dodge one-ton canopy truck therein mentioned, and that no judgment has been rendered, and there is no controversy can be had thereover until such judgment be rendered, and therefor the controversy in question does not exceed the sum of Three Thousand and no/100 (\$3000.00) Dollars, and the Court is without the jurisdiction to entertain the same.

3. To dismiss the action upon the ground that there is another action pending involving the same issues involved in the present action, namely the action of "L. L. Booze, plaintiff, versus Frank L. Vincent, an individual, Frank L. Vincent doing business under the firm name and style of Vincent's Dairy, et al, defendants", which said action is pending in the Superior Court of the County of Butte, State of California, and is case No. 18996, all of which is disclosed in the complaint of plaintiff on file herein, to which said complaint [13] reference is hereby made, and which is incorporated herein, and made a part hereof.

**J. OSCAR GOLDSTEIN and
JAMES WM. MORGAN**

Attorneys for L. L. Booze, de-
fendant, 142 W. Second St.,
Chico, California.

To: Betts and Garrison

Attorneys for Plaintiff:

Please take notice that the undersigned will bring the above motion on for hearing before this Court in the Courtroom thereof in the Federal Building

on "I" Street between Fifth Street and Sixth Street, in the City of Sacramento, County of Sacramento, State of California, on Monday the 19th day of October, 1942 at 10:00 o'clock A.M. in the forenoon of that day or as soon thereafter as counsel can be heard.

J. OSCAR GOLDSTEIN and
JAMES WM. MORGAN

Attorneys for L. L. Booze, de-
fendant, 142 W. Second
Street, Chico, Calif.

(Attached is Affidavit of Service by Mail)

[Endorsed]: Filed Sep 18 1942 [14]

[Title of Court and Cause.]

NOTICE OF APPEAL

To the Above Entitled Court: To the Defendant L. L. Booze and J. Oscar Goldstein and James Wm. Morgan, His Attorneys: To the Defendant Frank L. Vincent, an Individual, and Frank L. Vincent, Doing Business Under the Firm Name and Style of Vincent's Dairy, and to Messrs. Peters and Peters, His Attorneys:

Notice Is Hereby Given that American General Insurance Company, plaintiff above named, hereby appeals to The Circuit Court of Appeals for the Ninth Circuit, from the Order of Court dismissing

the Complaint, and from the final Judgment entered on said Order on the 25th day of February, 1943.

Dated: April 2, 1943

BETTS & GARRISON

By FORREST A. BETTS

Attorneys for Appellant American General Insurance Company, a corporation

[Endorsed]: Filed Apr 5 1943. [15]

At a stated term of the Northern Division of the United States District Court for the Northern District of California, held at the Court Room thereof, in the City of Sacramento, on Thursday the 25th day of February, in the year of our Lord one thousand nine hundred and 43.

Present: The Honorable Martin I. Welsh, District Judge.

No. 4526

AMERICAN GENERAL INSURANCE COMPANY, a corporation,

Plaintiff,

vs.

L. L. BOOZE, FRANK L. VINCENT, etc.,

Defendants

ORDER GRANTING MOTIONS TO DISMISS

The motions of defendants L. L. Booze and Frank L. Vincent having been heretofore heard and sub-

mitted, being now fully considered, it is Ordered that the motions of defendants L. L. Booze and Frank L. Vincent be and the same are hereby granted. [16]

[Title of District Court and Cause.]

DESIGNATION OF DOCUMENTS ON APPEAL

Comes Now the plaintiff in the above-entitled action, and by way of designation of documents to be prepared on appeal, in accordance with Rule 75 of the New Federal Procedure, does hereby designate the following:

- (1) The complaint;
- (2) Answer of defendant L. L. Booze;
- (3) Answer of Frank L. Vincent, individually, and Frank L. Vincent, doing business under the firm style and name of Vincent's Dairy;
- (4) Motion to Dismiss and Notice of Motion filed by and on behalf of the defendant Frank L. Vincent, [17] individually and doing business under the firm style and name of Vincent's Dairy;
- (5) Motion to Dismiss and Notice of Motion filed by and on behalf of the defendant L. L. Booze;
- (6) The Opinion or ruling of the Court determining that the Motions to Dismiss should be granted;
- (7) Order or Judgment of the Court on the 25th day of February, 1943, granting the Motions to Dismiss and Dismissing the Complaint herein;
- (8) Notice of Appeal;

(9) Designation of Documents on appeal.

Dated this 2nd day of April, 1943.

BETTS & GARRISON

By FORREST A. BETTS

Attorneys for Appellant, American General Insurance Company, a Corporation

[Endorsed]: Filed April 5, 1943 [18]

CERTIFICATE OF CLERK, U. S. DISTRICT
COURT TO TRANSCRIPT ON APPEAL

I, Walter B. Maling, Clerk of the United States District Court for the Northern District of California, do hereby certify that the foregoing 18 pages, numbered from 1 to 18, inclusive, contain a full, true and correct transcript of certain records and proceedings in the case of American General Insurance Company, a corporation, vs. L. L. Booze, Frank L. Vincent, et al., No. 4526, as the same now remain on file and of record in this office; said transcript having been prepared pursuant to and in accordance with the Designation of Documents on Appeal, copy of which is embodied herein.

I further certify that the cost of preparing and certifying the foregoing record on appeal is the sum of Seven and 10/100 (\$7.10) Dollars, and that the same has been paid to me by the attorney for the appellant herein.

In witness whereof, I have hereunto set my hand and the official seal of said District Court, this 23rd day of April, A.D. 1943.

[Seal] WALTER B. MALING,

Clerk

By T. M. LAMPERT

Deputy Clerk.

[Endorsed]: No. 10412. United States Circuit Court of Appeals for the Ninth Circuit. American General Insurance Company, a corporation, Appellant, vs. L. L. Booze, Frank L. Vincent, an individual, Frank L. Vincent, doing business under the firm name and style of Vincent's Dairy, Appellees. Transcript of Record. Upon Appeal from the District Court of the United States for the Northern District of California, Northern Division.

Filed April 26, 1943.

PAUL P. O'BRIEN

Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

United States Circuit Court of Appeals
for the Ninth Circuit

No. 10412

AMERICAN GENERAL INSURANCE
COMPANY, Appellant,
vs.

L. L. BOOZE, et al Respondents.

POINTS AND AUTHORITIES UPON WHICH
APPELLANT INTENDS TO RELY

That the Court committed error in its Ruling granting Defendants' Motions to Dismiss, in that, under the facts stated in the Complaint, this is a proper cause for *a*judication in the Federal Court under the Federal Declaratory Relief Act— and that the complaint contains all of the necessary elements to bring the cause within the requirements of the law.

Dated this 1st day of May, 1943.

BETTS & GARRISON,
By FORREST A. BETTS,
Attorneys for Appellant.

State of California,
County of Los Angeles—ss:

Bernice Barie, being first duly sworn, says:

That affiant is a citizen of the United States and a resident of Los Angeles County; that affiant is over the age of 18 years and is not a parto to the within action; that her business address is 419 Title

Insurance Building, Los Angeles, California; that on the 1st day of May, 1943, she served the within Points and Authorities on the Respondents in said action by placing a true copy in an envelope addressed to the respective attorneys of record for said respondents, at the office address of said attorneys, as follows: "Messrs. Oscar Goldstein and James Wm. Morgan, 142 West 2nd Street, Chico, California, and Messrs. Peters & Peters, 304 Broadway, Chico, California, and by then sealing said envelope and depositing the same, with postage thereon fully prepaid, in the U. S. Post Office at Los Angeles, California, where is located the office of the attorneys for the person by and for whom said service was made.

That there is a delivery service by U. S. Mail at the place so addressed.

BERNICE BARIE,

Subscribed and sworn to before me this 1st day of May, 1943.

[Seal]

M. MOORE,

Notary Public in and for said
County and State.

[Endorsed]: Filed May 3, 1943.

No. 10412

United States
Circuit Court of Appeals

For the Ninth Circuit.

AMERICAN GENERAL INSURANCE COM-
PANY, a corporation,

Appellant,

vs.

L. L. BOOZE, FRANK L. VINCENT, an indivi-
dual, FRANK L. VINCENT, doing business
under the firm name and style of Vincent's
Dairy,

Appellees.

SUPPLEMENTAL
Transcript of Record

Upon Appeal from the District Court of the United States
for the Northern District of California,
Northern Division.

I hereby certify that the annexed instrument is a true and correct copy of the original on file in my office.

Attest:

[Seal]

C. W. CALBREATH,

Clerk, District Court of the
U. S. Northern District of
California.

By F. M. LAMPERT,
Deputy Clerk.

[Endorsed]: Filed Jun 8, 1943.

[Title of District Court and Cause.]

NOTICE OF APPEAL

To the Above Entitled Court: To the Defendant L. L. Booze and J. Oscar Goldstein and James Wm. Morgan, His Attorneys: to the Defendant Frank L. Vincent, an Individual, and Frank L. Vincent, Doing Business Under the Firm Name and Style of Vincent's Dairy, and to Messrs. Peters and Peters, His Attorneys:

Notice Is Hereby Given that American General Insurance Company, plaintiff above named, hereby appeals to The Circuit Court of Appeals for the Ninth Circuit, from the Judgment of Dismissal en-

tered in the above entitled matter on the 8th day of June, 1943.

Dated this 31st day of July, 1943.

BETTS & GARRISON,
By FORREST A. BETTS,
Attorneys for Appellant
American General Insurance Company, a Corporation.

I hereby certify that the annexed instrument is a true and correct copy of the original on file in my office.

Attest:

[Seal]

C. W. CALBREATH,
Clerk, District Court of the
U. S. Northern District of
California.

By F. M. LAMPERT,
Deputy Clerk.

[Endorsed]: Filed Aug 2, 1943.

[Title of District Court and Cause.]

DESIGNATION OF DOCUMENTS ON APPEAL

Comes Now the plaintiff in the above-entitled action, and by way of designation of documents to be prepared on appeal, in accordance with Rule 75 of the New Federal Procedure, does hereby designate the following:

(1) Judgment of Dismissal in the above-entitled action, entered on June 8, 1943.

Dated this 31st day of July, 1943.

BETTS & GARRISON,
By FORREST A. BETTS,
Attorneys for Appellant,
American General Insurance Company, a Corporation.

I hereby certify that the annexed instrument is a true and correct copy of the original on file in my office.

Attest:

[Seal]

C. W. CALBREATH,
Clerk, District Court of the
U. S. Northern District of
California.

By F. M. LAMPERT,
Deputy Clerk.

[Endorsed]: Filed Aug. 2, 1943.

[Endorsed]: No. 10412. United States Circuit Court of Appeals, for the Ninth Circuit. American General Insurance Company, Appellant, vs. L. L. Booze, Frank L. Vincent, an individual and Frank L. Vincent, Doing Business Under the Firm Name and Style of Vincent's Dairy, Appellees. Supplemental Transcript of Record. Upon Appeal from the District Court of the United States for the Northern District of California, Northern Division.

Filed: August 24, 1943.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

No. 10412.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

AMERICAN GENERAL INSURANCE COM-
PANY, a corporation,

Appellant,

vs.

L. L. BOOZE, FRANK L. VINCENT, an
individual, FRANK L. VINCENT, doing
business under the firm name and style
of Vincent's Dairy,

Appellees.

APPELLANT'S OPENING BRIEF.

FORREST A. BETTS,

419 Title Insurance Building, Los Angeles,

Attorney for Appellant.

FILED

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THOMAS M. SMITH,
Clerk

TOPICAL INDEX.

	PAGE
Preliminary statement.....	1
Outline of issues.....	3
Issues	4
I.	
Federal court jurisdiction.....	4
A. General jurisdiction	4
B. Special jurisdiction under the Declaratory Relief Act....	5
1-B. All of the necessary elements by way of in- interested parties and actual justiciable controversy are present	6
2-B. There is no obligation on the part of appellant to any defendant.....	10
(a) There is no obligation under exclusion clause (e) of the policy !.....	10
(b) There is no obligation under the law of California!	10
II.	
The applicability of declaratory relief as applied to this par- ticular case	15
A. The issues of whether or not there is coverage in- volves, of necessity, the question of whether or not there is an original duty to make large expenditures for defense	15
1-A. A discussion of the applicability law—excerpts from Borchard	16
2-A. A discussion of the case law as related to the only two issues raised by the motion to strike....	20
III.	
Conclusion	27

TABLE OF AUTHORITIES CITED.

CASES.	PAGE
Aetna Cas. & Surety Co. v. Howell, 108 Fed. (2d) 148.....	25
Alaska Packers Assn. v. Marshall, 95 Fed. (2d) 279.....	14
Beatty v. San Diego Electric Ry. Co., 5 Cal. Ind. Dec. 241.....	14
Buttner v. American Bell Tel. Co., 41 Cal. App. (2d) 581.....	11
Commercial Casualty Ins. Co. v. Humphrey, 13 Fed. Supp. 174	4
Jennings v. Day, 7 Cal. App. (2d) 555.....	7
Maryland Casualty Co. v. Hubbard, 22 Fed. Supp. 697.....	20
Maryland Casualty Co. v. Pac. Coal & Oil Co., 312 U. S. 270....	27
Merchants Mut. Cas. Co. v. Drown, 199 Atl. 568, 89 N. H. 363	24
Moore v. L. A. Iron & Steel Co., 89 Fed. 73.....	8
Ocean Accid. & G. Corp. v. Washington Brick & T. C. Co., 148	
Va. 829, 139 S. E. 513.....	25
Ohio Casualty Ins. Co. v. Plummer, 13 Fed. Supp. 169.....	4
Sarber v. Aetna Life Ins. Co., 23 Fed. (2d) 434.....	14
Smith v. Fall River, etc. Dist., 1 Cal. (2d) 331.....	6
Surgeon v. Alaska Packers Assn., 26 Fed. Supp. 241.....	14
Union Lumber Co. v. Ind. Acc. Comm., 12 Cal. App. (2d) 588	14

STATUTES.

Federal Declaratory Relief Act, 28 U. S. C. A., Sec. 400.....	5
Insurance Code, Sec. 11650.....	10
Insurance Code, Sec. 11662.....	10

No. 10412.

IN THE

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FOR THE NINTH CIRCUIT

AMERICAN GENERAL INSURANCE COM-
PANY, a corporation,

Appellant,

vs.

L. L. BOOZE, FRANK L. VINCENT, an
individual, FRANK L. VINCENT, doing
business under the firm name and style
of Vincent's Dairy,

Appellees.

APPELLANT'S OPENING BRIEF.

Preliminary Statement.

This cause comes up on appeal from an order and judgment thereon dismissing the complaint.

The complaint is for Declaratory Relief, predicated upon the proposition that the California Workmen's Compensation Act provides the exclusive recourse of an employee against his employer. From this premise it is concluded that since there is no longer a common law right of action in the employee against the employer because of

alleged negligence of the latter in driving his motor vehicle, there likewise is, for such an accident, no coverage engendered from a policy of an insurance company indemnifying the employer against responsibility for claimed negligence on his part in driving such motor vehicle.

The purpose of this cause of action was to have the Court declare the rights of the parties under the policy-contract issued by the plaintiff American General Insurance Company, a corporation (hereinafter called "American General") to Frank L. Vincent (hereinafter called "Vincent"). The defendant L. L. Booze (hereinafter called "Booze") was sued as an interested party. The minor son of Booze was killed in the accident described in the complaint, and Booze has brought suit in the State Court for alleged wrongful death, naming in said suit not only his employer Vincent, but also one Ray White, the driver, and we believe owner, of the automobile which came into collision with the Vincent truck. Since deceased was a minor, Booze is the only person to whom would occur the cause of action, if any, for wrongful death.

Outline of Issues.

I.

FEDERAL COURT JURISDICTION.

A. GENERAL JURISDICTION.

B. SPECIFIC JURISDICTION UNDER THE DECLARATORY RELIEF ACT.

1-B. ALL OF THE NECESSARY ELEMENTS BY WAY OF INTERESTED PARTIES AND ACTUAL JUSTICIABLE CONTROVERSY ARE PRESENT.

2-B. THERE IS NO OBLIGATION ON THE PART OF APPELLANT TO ANY DEFENDANT.

(a) THERE IS NO OBLIGATION UNDER EXCLUSION CLAUSE "E" OF THE POLICY.

(b) THERE IS NO OBLIGATION UNDER THE LAW OF CALIFORNIA.

II.

THE APPLICABILITY OF DECLARATORY RELIEF TO THIS
PARTICULAR CASE.

A. THE ISSUES OF WHETHER OR NOT THERE IS COVERAGE INVOLVES, OF NECESSITY, THE QUESTION OF WHETHER OR NOT THERE IS AN ORIGINAL DUTY TO MAKE LARGE EXPENDITURES FOR DEFENSE.

1-A. A DISCUSSION OF THE APPLICABILITY LAW EXCERPTS FROM BORCHARD.

2-A. A DISCUSSION OF THE CASE LAW AS RELATED TO THE ONLY TWO ISSUES RAISED BY THE MOTION TO STRIKE.

III.

CONCLUSION.

ISSUES.

I.

Federal Court Jurisdiction.

The general jurisdiction of the Federal Court depends, in this case, on the diversity of citizenship between the appellant on the one hand and the respondents on the other. There was no issue raised but that these pleadings sufficiently alleged that appellant is a citizen of the State of Texas. [See par. I of the complaint, Tr. of Rec. p. 2.]

In addition, of course, there must be a sufficient allegation that the amount involved a value of \$3,000.00. That allegation is contained in paragraph VI of the complaint, at the bottom of page 5 and at the top of page 6 of the Transcript of Record.

Therefore, as was said in *Ohio Casualty Ins. Co. v. Plummer*, 13 Fed. Supp. 169:

“There is a diversity of citizenship, and the controversy involves more than \$3000, exclusive of interest and costs, and the court has jurisdiction. (Jud-Code Sec. 24(1) section 41, title 28, U. S. C. A.; *United States v. West Virginia*, 295 U. S. 463, etc.)”

See also a companion case, *Commercial Casualty Ins. Co. v. Humphrey*, 13 Fed. Supp. 174, where, at page 178, the court said:

“Plaintiff’s suit is to declare the rights and other legal relations of the parties to the suit under the policy. Under the policy plaintiff may be liable for as much as \$10,000 for . . . one person, \$20,000 for . . . the same accident, etc. . . . The test of jurisdiction is not what Pierce may claim against plaintiff, but the maximum amount for which

plaintiff may be liable under the policy. The case comes within the principle announced by the Supreme Court in *Packard v. Bahton*, 264 U. S. 140, 142, etc. . . . I entertain no doubt that the amount in controversy here involves more than \$3000, exclusive of interest and costs, and that the court has jurisdiction."

B. SPECIAL JURISDICTION UNDER THE DECLARATORY RELIEF ACT.

Having established the general jurisdiction of the Federal Court, a condition precedent to any consideration of the complaint, the next problem is to bring the case under the provisions of the Federal Declaratory Relief Act, 28 U. S. C. A., Section 400. Of this Act, paragraph (3), referring to trial jury, is not here material. The first two paragraphs of the Act are:

"(1) In cases of actual controversy the courts of the United States shall have power, upon petition, declaration, complaint, or other appropriate pleadings to declare rights and other legal relations of any interested party petitioning for such declaration, whether or not further relief is or could be prayed, and such declaration shall have the force and effect of a final judgment or decree and be reviewable as such.

"(2) Further relief based on a declaratory judgment or decree may be granted whenever necessary or proper. The application shall be by petition to a court having jurisdiction to grant the relief. If the application be deemed sufficient, the court shall, on reasonable notice, require any adverse party, whose rights have been adjudicated by the declaration, to show cause why further relief should not be granted forthwith."

1-B. *All of the Necessary Elements by Way of Interested Parties and Actual Justiciable Controversy Are Present.*

Since the motion to dismiss, like its predecessor the demurrer, admits the truth of the allegations of the petition, yet challenge their sufficiency, despite such truth, our first duty is to analyze the Act to see what are the elements necessary to the establishment, or proper statement, of the cause of action. That analysis, it appears plainly, leaves only one real issue here to be weighed, namely, Is there an actual controversy?

(1) All of the "interested" parties are before the Court. These parties must be determined by inquiring, who, if anyone, would have the right or obligation under the indemnity contract if, after trial of the tort case on its merits, a judgment were entered in favor of Booze and against both White and Vincent?

In California, a tort-feasor is not entitled to contribution from his joint tort-feasors, if any. In the case of *Smith v. Fall River, etc. Dist.*, 1 Cal. (2d) 331, the insurance company had indemnified two of three defendants. A judgment in favor of the injured plaintiff was entered against all three defendants. On appeal, which affirmed the judgment, the same company wrote the surety bond for the same two defendants. The third defendant put up no stay bond. The company attempted to pay the judgment in its capacity as a surety, and then assert subrogation rights against the third defendant (who was apparently uninsured and who put up no stay bond). At page 334, the Court said:

"As appellant cannot recover from either the district or Fitzwater by reason of its indemnity bond.

can it recover against the respondent whose negligence concurred with that of Fitzwater in causing plaintiff's injuries? It is well settled in this state that there is no right of contribution between joint tort-feasors whose concurrent negligence has made them jointly liable in damages. (*Adams v. White Bus Line*, 184 Cal. 710 (195 Pac. 389).) Therefore, had either of the two defendants, the school district or Fitzwater, paid said judgment, no claim for contribution against the respondent could have been made by the defendant making said payment. Neither could the appellant, after paying the judgment as the indemnitor of the two defendants, the school district and Fitzwater, compel contribution or recover anything from the respondent, a joint tort-feasor with the other two defendants. This was the point involved and definitely settled in the case of *Adams v. White Bus Line, supra.*"

Likewise, in *Jennings v. Day*, 7 Cal. App. (2d) 555, at page 557, the court remarked:

"The first point made by the appellant is that the evidence is insufficient to justify the finding that the defendant Davidson was not negligent. Appellant admits that if the court found that Davidson was guilty of negligence this would not excuse Day. He contends, however, that the trial court obviously ignored the evidence and found Day solely liable for the accident and that appellant was, therefore, not afforded a fair and impartial trial. Appellant cannot complain of the action of the trial court in finding that Davidson was not negligent. There is no right of contribution between two joint tort-feasors, and respondent is the only party aggrieved by the finding of the trial court. (*Forsythe v. Los Angeles Ry. Co.*, 149 Cal. 569 (87 Pac. 24).)"

Therefore, the defendant White from our state court case is eliminated in this action—as not being an “interested” party. He is not “interested,” in the sense used in the Act, because no right accrues to him, nor has he any obligation related to the contract, no matter how the personal injury case in the state court might be decided. That he might have a very real practical interest in the payment of any judgment does not change his legal status as a joint tort-feasor.

(2) If there were a *valid* judgment in favor of Booze and against Vincent, then Vincent, under the terms of the contract, would be entitled to have payment of said judgment by his insurance carrier—up to the expressed limits of the policy. He therefore has a vital interest in this controversy.

(3) Booze, should he become the holder of a *valid* judgment against Vincent, either alone or jointly against White—would be entitled to have the judgment satisfied up to the limits expressed in the policy-contract. The indemnification in the present contract is one against loss, rather than one against liability.

The leading case in point seems to be the old one of *Moore v. L. A. Iron & Steel Co.*, 89 Fed. 73, decided by Judge Wellborn in 1898. In it he quotes from section 2777 of the California Civil Code as follows:

“One who indemnifies another against an act to be done by the latter, is liable jointly with the person indemnified, and separately, to every person injured by such act.”

The Court there held that, since the contract indemnified against *liability*, the cause of action arose against the insurance company immediately upon the happening of

the accident. It has remained the unimpeached authority that the injured party does have a right against the indemnitor. Where, as here, that indemnity does not ripen until loss, the injured party must first get judgment before bringing suit. That such "coercive" action is not necessary under Declaratory Relief.

Therefore, Booze, as a claimed prospective holder of a judgment against Vincent, becomes a prospective holder of rights against American General's policy and, as such, is established as an "interested" party in the legal sense in which the phrase is used in the Act.

(4) It is apparent that, as between both Booze and Vincent on the one hand, and American General on the other, the possible rights—those being claimed by Booze and Vincent—create possible obligations against American General because of the indemnity contract. That is, should there be a valid judgment for Booze, American General—if there were no contest concerning the policy coverage, etc.—would owe both Vincent and Booze the duty to pay up to its policy limits.

As between Vincent and American General there is still another question of rights and obligations, in which Booze is only secondarily interested, and that not from a money point of view. That question is whether or not there is any duty on the part of American General to furnish a defense to Vincent in the trial in the state court. If there is no right of recovery in Booze against Vincent as the employer of the deceased minor, then likewise there is no duty to defend.

Thus it is seen that all of the appearing parties are proper as being "interested" and, as a corollary, all of the necessary parties are named.

2-B. *There Is No Obligation on the Part of Appellant to Any Defendant.*

(a) There Is No Obligation Under Exclusion Clause (e) of the Policy!

A photostatic copy of the policy-contract, as issued by American General to Vincent, is attached to the complaint, marked Exhibit "A," and, by reference, is incorporated in the complaint as though fully set forth. See paragraph IV of Complaint, bottom of page 3 and top of page 4 of Transcript of Record. Exclusion clause (e) provides as follows:

"Under Coverage A, for such bodily injury to or death of any employ of the Insured while engaged in the business of the Insured, other than domestic employment, or in the operation, maintenance or repair of the automobile, or to any obligation for which the Insured may be held liable under any Workmen's Compensation Law."

NOTE: Coverage "A" is "Bodily Injury Liability."

(b) There Is No Obligation Under the Law of California!

The exclusion clause is expressed in agreement with the requirements of the California Workmen's Compensation Law.

The codified insurance laws of the State of California are contained between sections 11650 and 11662 of the Insurance Code, enacted in 1935. It probably is not contended by any of the parties but that our policy *could not be construed* as covering a loss under the Workmen's Compensation Law. It is an ordinary automobile policy, and must be construed as such.

It is not open to doubt that exclusive jurisdiction lies with the Industrial Accident Commission to try and determine controversies of this type between the employer and employee under the laws regulating Workmen's Compensation!

The case of *Buttner v. American Bell Tel. Co.*, 41 Cal. App. (2d) 581 (November 22, 1940), is a comprehensive discussion of the established rule of law. In that case the court said, at page 583, *et seq.*:

"Appellant raises but one question here, namely, whether the provisions of article XX, section 21, of the California Constitution, creating the Industrial Accident Commission, 'bar an individual who has formerly been in the employ of the defendant, from bringing any action in the Superior Court, regardless of the nature of the action.' The question thus attempted to be raised, properly stated, is whether, in view of the said constitutional provisions and those of the Workmen's Compensation Act (now embodied in the Labor Code), the Superior Court has jurisdiction over a cause of action such as that alleged in appellant's first count in his complaint herein. As seen above, this is one of the questions raised by respondents' demurrer.

"There can be no question that said cause of action is one for damages for personal injuries. It also affirmatively appears that the injuries sustained arose out of and in the course of appellant's employment by respondents. The distinction attempted to be drawn by appellant between this case and the ordinary workmen's compensation case is that here appellant bases his cause of action upon the alleged deceit of respondents in misrepresenting the nature of a substance used by appellant while in respondents' employ. In

other words, the proximate cause of appellant's injuries is stated to be a willful act of his employer.

"It appears that appellant's injuries were sustained prior to the enactment of the pertinent provisions of the Labor Code and at a time when the Workmen's Compensation Act was in force. Section 21 of article XX of the California Constitution gives to the legislature plenary power to create and enforce a complete system of workmen's compensation, by appropriate legislation. To that end the legislature enacted the provisions of the Workmen's Compensation Act, now contained in the Labor Code. (Stats. 1917, p. 831, as amended; Act 4749 Deering's General Laws, 1937; now contained in Division IV of the Labor Code.) Under those provisions the Industrial Accident Commission of the state is given exclusive jurisdiction over matters of compensation for any injury arising out of employment, such as that of appellant here. It is not claimed that appellant's employment was of a type excluded by such provisions, and while it appears that respondents are all part of the "Bell System" of telephone service, it does not appear, nor is it claimed that appellant was engaged in work in interstate commerce, but on the contrary, it affirmatively appears from the complaint that appellant was employed at work in the county of Los Angeles, State of California. The exclusive jurisdiction of the Industrial Accident Commission over such claims as that presented by appellant's first cause of action is well settled, and a demurrer on the ground, among others, that the court had no jurisdiction of the subject matter of the action was properly sustained. (*Burton v. Union Oil Co.*, 129 Cal. App. 438 (19 Pac. (2d) 9). See, also, *Alaska Packers Assn. v. Industrial Accident Com.*, 200 Cal. 579, 583 (253

Pac. 926), citing *De Carli v. Associated Oil Co.*, 57 Cal. App. 310 (207 Pac. 282); *Fitzpatrick v. Fidelity & Casualty Co.*, 7 Cal. (2d) 230, 233 (60 Pac. (2d) 276); *Tipton v. Atchison, T. & S. F. R. Co.*, 298 U. S. 141, 154 (56 Sup. Ct. 715, 80 L. Ed. 1091, 104 A. L. R. 831).)

“The fact that appellant founds his cause of action upon the deceit allegedly practiced by respondents is immaterial. It cannot be disputed that the jurisdiction of the Industrial Accident Commission prevails regardless of the cause of accident or injury. Compensation for injuries caused by the serious and willful misconduct of the employer is expressly provided for in section 6 of Workmen’s Compensation Act, now section 4553 of the Labor Code. It is clear that section 21 of article XX of the Constitution and the legislation enacted pursuant thereto are intended to include all injuries incurred in the course of employment, irrespective of the manner in which they might occur. (*Sarber v. Aetna Life Ins. Co.*, 23 Fed. (2d) 434.)

“It should be noted that the *Sarber* case, *supra*, concerned an action in damages for deceit on the part of the employer’s insurance company in concealing from plaintiff the fact that a fragment of steel had not been removed from his leg following an accident in the course of his employment. A demurrer was interposed on the ground of the lack of jurisdiction of the court over the subject matter, which demurrer was sustained. Plaintiff was an employee within the contemplation and under the provisions of the California Workmen’s Compensation Act, and the Federal Circuit Court of Appeals for the Ninth Circuit upheld the ruling on the demurrer on the ground of the exclusive jurisdiction of the In-

dustrial Accident Commission over such matters, even where disability has been aggravated by the intervening negligence or carelessness of the employer's physician. It follows that if negligence or carelessness which aggravates the injury does not affect the jurisdiction of the commission, then the willful misconduct or other act which caused the injury is likewise unimportant in that respect. The *Sarber* case is directly in point here, and should be controlling if further authority were needed."

We will not attempt to further amplify the discussion except to note the rule's approbation by the Federal Court in the *Sarber* case. On this point we also commend to the Court the case of *Surgeon v. Alaska Packers Assn.*, 26 Fed. Supp. 241, and the case therein cited of *Alaska Packers Assn. v. Marshall*, 95 Fed. (2d) 279, both in the Ninth Circuit, sustain this jurisdiction even to the exclusion of Federal courts.

The complaint reveals that, as a part of the controversy, the parties take opposite sides on the question of whether or not the deceased (who was learning a dairy route so that he could substitute while the regular boy took a week's vacation), was an employee.

As was said in *Beatty v. San Diego Electric Ry. Co.*, 5 Cal. Ind. Acc. Dec. 241 (approved by the California Appellate Court in *Union Lumber Co. v. Ind. Acc. Comm.*, 12 Cal. App. (2d) 588 at 596):

"Applicant sustained an injury in the course of his employment while acting as 'student' motorman on the defendant's street railway *without pay*, it being the expectation that by two days later he would have learned the routes and would be put on the payroll as a regular motorman. The Commission held that there existed a contract of hire . . ."

II.

The Applicability of Declaratory Relief as Applied to
This Particular Case.

A. THE ISSUES OF WHETHER OR NOT THERE IS COVERAGE INVOLVES, OF NECESSITY, THE QUESTION OF WHETHER OR NOT THERE IS AN ORIGINAL DUTY TO MAKE LARGE EXPENDITURES FOR DEFENSE.

It is apparent from the foregoing statements that there is an “actual controversy” between the “interested” parties, all of whom are before the Court.

The justiciability of the controversy is shown by the allegations of paragraph IX of the complaint [pages 8 and 9 of Transcript of Record]. Noteworthy is the fact that the controversy is not limited alone to responsibility for payment of any judgment which might be entered in the state court. *It invoked also the question of whether or not American General must expend a considerable amount of money to defend the state court action.* Therefore, all of the controversies could not possibly be decided in the California court, even if this appellant were a party to that case. Appellant is not a party to the personal injury case, and could not properly be forced to appear therein. To say that appellant may defend in the tort action, and perhaps thereby determine most of the issues, does not do justice, because it would require defendant to waive its right not to defend if there is no coverage—a waiver which could, of itself, demand the expenditure of considerable sums of money.

The necessity to set up large contingent reserves against possible and uncertain loss, and the expense incident thereto, even in the event of an ultimate successful defense, are penalties which appellant should not be re-

quired to stand if, in fact and in law, there was no coverage under the policy.

It is apparent from the alleged facts, which are required to be admitted for the purposes of this appeal to be true, that appellant has presented justifiable issues which would entitle American General to the relief as prayed for.

1-A. *A Discussion of the Applicability Law—
Excerpts From Borchard:*

By way of aid to our position, we suggest the review of a few statments by the author of the laws governing Declartory Relief in this country. At page 634 *et seq.* of the second edition of Declartory Judgments by Borchard, the author says:

“Insurance contracts, by virtue of their aleatory character and the many parties that may become involved, have proved to be peculiarly susceptible to declaratory adjudication, whether before or after the risk has matured. This has been especially true of casualty insurance policies, which insure under certain conditions against injuries to third parties whose claims against the insured, his employees and the company have presented some of the most interesting cases of recent years. . . .

“In addition, certain economic and social facts have played a part in encouraging resort to declaratory rather than coercive relief. On the part of the insured or beneficiary, a declaration of liability against a company, since most insurance companies are responsible, is as effective as a money judgment or coercive relief, and it is cheaper, speedier and more efficient. Numerous actions have been brought

simply to declare in force a policy from which a company sought to escape by reason of alleged breach by the insured. On the part of the insurance company other conditions operate. When a casualty company is a defendant or co-defendant with the insured, juries are apt to be swayed by sympathy and be partial to the plaintiff; hence insurers have found great advantage in segregating the factual issue of coverage or breach by the insured and obtaining a declaratory judgment in an independent action to the effect that there was 'no coverage' under the policy or that the company's defense was sound and exonerated it from further participation in the case. Not only is the company relieved by a judgment in its favor from defending a negligence action against the insured, but the determination of the fundamental economic fact that there is 'no coverage' enlightens and guides the injured person and the insured. Indeed, such a determination has basic importance for all parties concerned in the negligence action, whether an injunction against its continuance is issued or not, for a suit against an impecunious insured unsupported by a responsible insurer may not be pursued, or else the passive indifference of the insured may well be converted into self-reliant defense.

"The passage of the Federal Declaratory Judgments Act in 1934 has opened up a vast area of declaratory relief which has been especially availed of by insurance companies seeking to escape the obligation of defending a negligence suit brought against the insured or of paying a judgment that might be found against him, on the ground that the policy did not cover the risk and that the company should be relieved of all liability in the case. The clearing up of this fundamental question of coverage and of com-

pany liability has proved an advantage in many cases and has on the whole been looked upon with favor by the courts. The declaratory action for immunity has often been filed in the federal court when diversity of citizenship existed, whereas the action or actions for negligence have been brought in the state courts. . . .”

And at page 645:

“Possibly the greatest interest in the development of declaratory procedure has been aroused by the privilege which it affords to the party charged or the debtor or obligor to disavow liability or claim exemption, exoneration or release from a burden to which ostensibly he is exposed. As already observed, equity long has recognized a legal interest in the removal of clouds from title to real estate, but it had until recently failed to perceive that any unjustified claim created a legal interest in the party charged to have the claim declared invalid. Instead of awaiting the pleasure of the accuser or claimant in bringing his demand or claim to adjudication, legislators and courts have found that social peace is promoted by taking under judicial cognizance the desire of the party charged or in jeopardy to be relieved of the peril, the insecurity and the uncertainty created by an unjust claim, actual or potential. The procedure for declaratory adjudication has thus served as a stabilizer of legal relations.”

And at page 646:

“The insurance cases which have attracted most attention to the declaratory judgment are those in which a casualty company institutes an action against the insured, joining or not joining the injured parties,

for a declaration that the company is *not* under a duty to defend or to pay any eventual judgment, because the injury or death is not within the coverage of the policy or because the company has some defense which exempts it. The courts, especially those of New Hampshire and the federal courts, having at once conceded that the issue presented a 'case' or 'controversy,' made the propriety of issuing the declaration turn on questions of policy and discretion in trying the issue of non-liability or limited liability *before* the suit of the injured person for negligence had been litigated to judgment, and raised the question whether that suit should be stayed or the company be relegated to its defense in that suit."

And at page 647:

"For one or more of these reasons, insurance companies have had occasion to avail themselves of this opportunity to obtain relief from unjust claims by suing the insured or his beneficiary for a declaration of non-liability, for lack of coverage or because the insured's breach of warranty or condition of risk or covenant excuses them from liability or from defending the insured against third party claims or paying any judgment thus obtained. . . ." (Italics added.)

And at page 652:

"It is therefore of exceptional importance to both insurer and insured, if not indeed to the injured person, to know at the earliest possible moment whether the policy covers the loss or not. The liability under the policy and the liability for negligence are indeed two separate transactions. While in general the parties in interest are the same, the company is not usually, except for statute, a party to the negligence

action. It may be important, therefore, to try the question of immunity separately. This is especially so where an impecunious or complaisant insured is involved who will readily admit liability and accept judgment against him *pro confesso*, both he and the injured person realizing that the real parties in interest are none other than the company and the injured person. If the company were exempt, there might be no lawsuit for alleged negligence. Moreover, the insured or injured person may delay his suit, as in the *Haworth* case, and it might work an injustice entailing loss of evidence, the setting up of reserves and other inconvenience and suspense to have to await the pleasure of the insured or injured person to commence the action. In some states, indeed, the company's defense of the suit for negligence is a bar against any later disclaimer of liability in the subsequent action for indemnity."

2-A. *A Discussion of the Case Law as Related to the Only Two Issues Raised by the Motion to Strike.*

The motions of Booze and Vincent to dismiss, although prepared by separate counsel—opponents in the state court—are in identical words. Other than the general claim that no cause is stated, they present alleged grounds which long since, and often, have been determined in favor of appellant.

The case of *Maryland Casualty Co. v. Hubbard*, 22 Fed. Supp. 697, is a clear statement on the first point. There co-insurers were parties, and a motion to dismiss was made upon the ground that no cause of action was stated. Discussing like problems Judge Yankwich said:

"Its position is that there is no privity between it and the plaintiff. It says that only after Hubbard

secures a judgment against Ridgeway Audit, Inc., and the plaintiff pays it, would it be subrogated to whatever right of action Ridgeway Audit, Inc., had against defendant company by reason of the Petronovich policy. This right, it declares, is purely contingent and dependent upon the happening of future events which have not yet occurred or upon an issue which has not yet ripened and which is outside of the power of the court to determine through a declaratory judgment.

“To be entertained under the Declaratory Judgments Act, controversies must be justiciable.

“In *Aetna Life Insurance Co. v. Haworth*, 1937, 300 U. S. 227, 240, 241, 57 S. Ct. 461, 464, 81 L. Ed. 617, 108 A. L. R. 1000, the court has stated the conditions which make for justiciability: ‘*The controversy must be definite and concrete, touching the legal relations of parties having adverse legal interests.* * * * It must be a real and substantial controversy admitting of specific relief through a decree of a conclusive character, as distinguished from an opinion advising that the law would be upon a hypothetical state of fact. * * * Where there is such a concrete case admitting of an immediate and definitive determination of the legal rights of the parties in an adversary proceeding upon the facts alleged, the judicial function may be appropriately exercised although the adjudication of the rights of the litigants may not require the award of process or the payment of damages.’ (Italics added.)

“In interpreting declaratory judgments acts, the trend is to extend their benefit to the interests of parties which are jeopardized or challenged even before a right of action exists or cause of action accrues. Borchard says: ‘The opposition to the plain-

tiff's demand must come from a source competent legally to jeopardize his rights. Where, however, that is conceded, it still remains to determine whether the plaintiff has a sufficient interest, pecuniary or personal, to institute a proceeding worthy of judicial relief. He must show that his rights are in direct issue or jeopardy; and incidental thereto, must show that the facts are sufficiently complete, mature, proximate, and ripe to place him in gear with his adversary, and thus to warrant the grant of judicial relief. Just when the controversy has reached the stage of maturity cannot be *a priori* defined.' *Borchard, Declaratory Judgment* (1934), p. 36.

"A declaration of nonliability is within the ambit of justiciability. *Edwin Borchard, Justiciability* (1936), 4 *University of Chicago Law Review*, 1-24; *Borchard, Recent Developments in Declaratory Relief* (1936), 10 *Temple Law Quarterly*, 233.

"In the field of liability insurance, the right to a judicial declaration of liability or nonliability upon the happening of the accident has been given full recognition. *Aetna Life Insurance Co. v. Haworth*, 1937, 300 U. S. 227, 57 S. Ct. 461, 81 L. E. 617, 108 A. L. R. 1000: . . . And see *John A. Appleman, 'Automobile Insurance and the Declaratory Judgment'*, 1937, 23 A. B. A. Journal, 551.

"A demand that the insurer defend an action warrants an appeal to courts for a declaration of nonliability. *Associated Indemnity Corporation v. Manning*, 1937, 9 Cir., 92 F. 2d 168; . . . When the policy obligates the insurer to defend, declarations seeking to free him from the obligation have been entertained even when *no demand* to defend a pending action had actually been made on him. *Ohio Casu-*

alty Ins. Co. v. Plummer, 1935, D. C. Tex., 13 F. Supp. 169; . . .

“These decisions accord with others holding that courts may intervene by way of declaration ‘either before or after the stage of relief by coercion has been reached.’ *Gully v. Interstate Natural Gas Co.*, 1936, 5 Cir., 82 F. 2d 145, 149; . . .

“To apply these principles to the facts here:

“An action for damages resulting from the injury is pending. The bill, the allegations of which are taken as true, for the purpose of the motion to dismiss, *Hill v. Wallace*, 1922, 259 U. S. 44, 61, 42 S. Ct. 453, 455, 66 L. Ed. 822; *Arizona v. California*, 1931, 283 U. S. 423, 452, 51 S. Ct. 522, 525, 75 L. Ed. 1154; *San Francisco S. News Co. v. City of South Francisco*, 1934, 9 Cir., 69 F. 2d 879, avers that both policies cover the risk. The insured under the plaintiff’s policy, Ridgeway Audit, Inc., is a party to this action. But while the insured under the defendant-insurer’s policy (Petronovich) is not a party, because he is beyond our jurisdiction, the bill avers that the policy insured also to the benefit of the defendant Blackwell, who was driving with the owner’s consent. If judgment in the action for damages, to which it is also a party, be against Ridgeway Audit, Inc., it would be entitled to reimbursement from Blackwell and from the defendant-insurer.

“The plaintiff, if compelled to pay the judgment, by reason of its coverage, would be subrogated to the rights of Ridgeway Audit, Inc., against the defendant. *Central Surety & Ins. Corporation v. London & Lancastershire Indemnity Co.*, 1935, 181 Wash. 353, 43 P. 2d 12; . . .

“Often has a declaration been allowed, although liability depended upon a contingency which had not yet happened. . . .

“Neither insurer could be joined in that action. *Van Derhoof v. Chambon*, 1932, 121 Cal. App. 118, 8 P. 2d 925. So their respective obligations cannot be determined there. Therefore, one of them comes here and seeks a declaration of the conditions of its liability which, if made, will amount to a declaration of no obligation to defend and of conditional liability for judgment, *i. e.*, liability only after the full liability of the defendant-insurer has been discharged under its policy.

“Assume that no compulsory judgment of any kind could be rendered against the defendant-insurer, this does not stand in the way of a declaration. . . .

“So here, while the defendant-insurer may not be liable, at present, to the plaintiff, it is as much interested in the determination of that liability as the plaintiff. And, as the determination of its liability might affect adversely that of the plaintiff, the controversy is ripe for determination. *Borchard, Declaratory Judgments* (1934), pp. 35, 40, 42.”

In an action for declaratory judgment in *Merchants Mut. Cas. Co. v. Drown*, 199 Atl. 568 (89 N. H. 363), the Court, at page 569, said:

“The sole question of law involved is whether Drown’s injuries were compensable under the Workmen’s Compensation Act. If they were, the plaintiff’s policy does not cover, *and the plaintiff is under no duty to defend Drown’s action against Olson* (an additional assured under the automobile policy). If (they) were not, there is coverage.” (Italics and parenthetical explanation added.)

We quote from the last case not only because it is one where a declaratory judgment was awarded, but one where the issue on which the action was predicated was the same.

On the general point that these casualty policy problems may properly be clarified by declaratory judgment see also *Aetna Cas. & Surety Co. v. Howell*, 108 Fed. (2d) 148.

We mentioned above the fact that American General is not alone contending that there is no obligation to pay a judgment; that one of the very purposes of this action for declaratory judgment is to determine whether or not there is a duty to *defend*. An interesting discussion of this point appears at page 517 of 139 S. E. (*Ocean Accid. & G. Corp. v. Washington Brick & T. C. Co.*, 148 Va. 829, 139 S. E. 513). The Court said:

“It is contended, however, by counsel for the brick company, that the insurer was bound by the terms of its policy to defend all suits and actions, or other proceedings, instituted against the employer; basing the argument in this respect upon the third clause of the policy above transcribed. We cannot agree with the argument in this respect. It is true that the provisions of the policy alluded to may have the effect of binding the insurer to defend all suits, although ‘such suits, or other proceedings, allegations, or demands are wholly groundless, false, or fraudulent,’ as stated in the policy. *It is scarcely logical to hold that this provision concerning the right and obligation to defend the suit, which is often contained in the indemnity policies, would be intended to bind the insurer to take charge of and defend a suit in which, under the terms of the policy, it had no interest. If this is true, it would result in compelling the insurer to waive its claim of nonliability, because it is quite generally held that, if the insurer does*

defend and a judgment results against the employer, the insurer is bound to pay the judgment. *The language of the policy which requires the insurer to defend suits which may at any time be instituted against the employer 'on account of such injuries, including suits or other proceedings alleging such injuries and demanding damages or compensation therefor,' must be read in connection with the fundamental contractual obligation appearing upon the face of the contract between the parties, which was that the insurer would indemnify the employer only in case of recovery of damages by employees legally employed.*" (Italics added.)

From these cases clearly it must be concluded that the mere pendency of the tort action in the state court cannot be a bar to this action. Neither the parties nor the issues coincide! First, American General is not a party to that action, and may not properly be made such. Second, not all of the issues here presented can be tried in the state court action. This must be conceded, even though all but one of them might be concluded by indirection. To be *concluded* by the result of the trial of an issue in the state court—as might be true of the issue of employment—is not the same as having that issue *tried*! Further, we contend that Vincent, in turn, contends that the deceased was *not* an employee. So, that issue may never be tried in the state court action for there would seem to be an agreement between Booze and Vincent on this issue. Third, there is one extremely important issue that could never be tried if American General were required to defend Vincent in the state court before having the question of coverage decided. That is the question of whether or not there is any *duty* to defend.

III.

Conclusion.

We think it fitting to conclude with a quotation from *Maryland Casualty Co. v. Pac. Coal & Oil Co.*, 312 U. S. 270. In that case there was a pending action in the state court, yet the Supreme Court held that other necessary elements of federal jurisdiction (diversity of citizenship and a controversy of more than \$3000) having been established, the action for declaratory relief was proper. The facts are so near those in our own case as to leave no doubt of our right to have our causes tried. In that case the court said:

“Petitioner issued a conventional liability policy to the insured, the Pacific Coal & Oil Co., in which it agreed to indemnify the insured for any sums the latter might be required to pay to third parties for injuries to person and property caused by automobiles hired by the insured. Petitioner also agreed that it would defend any action covered by the policy which was brought against the insured to recover damages for such injuries.

“While the policy was in force, a collision occurred between an automobile driven by respondent Orteca and a truck driven by an employee of the insured. Orteca brought an action in an Ohio state court against the insured to recover damages resulting from injuries sustained in this collision. Apparently this action has not proceeded to judgment.

“Petitioner then brought this action against the insured and Orteca. Its complaint set forth the facts detailed above and further alleged that at the time of the collision the employee of the insured was driving a truck sold to him by the insured on a conditional sales contract.

“Petitioner claimed that this truck was not one ‘hired by the insured’ and hence that it was not liable to defend the action by Orteca against the insured or to indemnify the latter if Orteca prevailed. It sought a declaratory judgment to this effect against the insured and Orteca, and a temporary injunction restraining the proceedings in the state court pending final judgment in this suit.

“Orteca demurred to the complaint on the ground that it did not state a cause of action against him. The District Court sustained his demurrer and the Circuit Court of Appeals affirmed. 111 F. 2d 214. We granted certiorari, 311 U. S. 625, to resolve the conflict with the decisions of other Circuit Courts of Appeals cited in the note.

“The question is whether petitioner’s allegations are sufficient to entitle it to the declaratory relief prayed in its complaint. This raises the question whether there is an ‘actual controversy’ within the meaning of the Declaratory Judgment Act (Judicial Code sec. 274d, 28 U. S. C. sec. 400), since the District Court is without power to grant declaratory relief unless such a controversy exists. *Nashville, C. & St. L. Ry. Co. v. Wallace*, 288 U. S. 249, 259; U. S. C. A. Constitution, Art. III, sec. 2.

“The difference between an abstract question and a ‘controversy’ contemplated by the Declaratory Judgment Act is necessarily one of degree, and it would be difficult, if it would be possible, to fashion a precise test for determining in every case whether there is such a controversy. Basically, the question in each case is whether the facts alleged, under all the circumstances, show that there is a substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality to war-

rant the issuance of a declaratory judgment. See *Aetna Life Ins. Co. v. Haworth*, 300 U. S. 227, 239-242. It is immaterial that frequently, in the declaratory judgment suit, the positions of the parties in the conventional suit are reversed; the inquiry is the same in either case. *Nashville, C. & St. L. R. Co. v. Wallace*, *supra*, p. 261.

“That the complaint in the instant case presents such a controversy is plain. Orteca is now seeking a judgment against the insured in an action which the latter claims is covered by the policy, and secs. 9510-3 and 9510-4 of the Ohio Code (Page’s Ohio General Code, Vol. 6, secs. 9510-3, 9510-4) give Orteca a statutory right to proceed against petitioner by supplemental process and action if he obtains a final judgment against the insured which the latter does not satisfy within thirty days after its rendition. Compare *Maryland Casualty Co. v. United Corporation*, 111 F. 2d 443, 446; *Central Surety & Insurance Corp. v. Norris*, 103 F. 2d 116, 117; *U. S. Fidelity & Guaranty Co. v. Pierson*, 97 F. 2d 560, 562. Moreover, Orteca may perform the conditions of the policy issued to the insured requiring notice of the accident, notice of suit, etc., in order to prevent lapse of the policy through failure of the insured to perform such conditions. *Hartford Accident & Indemnity Co. v. Randall*, 125 Ohio St. 581, 183 N. E. 433; see also, *Lind v. State Automobile Mutual Insurance Assn.*, 128 Ohio St. 1, 190 N. E. 138; *State Automobile Mutual Insurance Assn. v. Friedman*, 122 Ohio St. 334, 171 N. E. 591.

“It is clear that there is an actual controversy between petitioner and the insured. Compare *Aetna Life Ins. Co. v. Haworth*, *supra*. If we held contrariwise as to Orteca because, as to him, the controversy

were yet too remote, it is possible that opposite interpretations of the policy might be announced by the federal and state courts. For the federal court, in a judgment not binding on Orteca, might determine that petitioner was not obligated under the policy, while the state court, in a supplemental proceeding by Orteca against petitioner, might conclude otherwise. Compare *Central Surety & Insurance Corp. v. Norris*, *supra*, p. 117; *Aetna Casualty & Surety Co. v. Yeatts*, 99 F. 2d 665, 670.

“Thus we hold that there is an actual controversy between petitioner and Orteca, and hence, that petitioner’s complaint states a cause of action against the latter.”

We do, therefore, respectfully represent that the order dismissing the complaint must be reversed. We pray that the Court consider the other matters presented so that, should the facts establish that the deceased was an employee of Vincent, then Booze must confine his right of recovery to that provided by the Workmen’s Compensation Act.

Respectfully submitted,

FORREST A. BETTS,

Attorney for Appellant.

No. 10,412

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

AMERICAN GENERAL INSURANCE COMPANY
(a corporation),

Appellant,

vs.

L. L. BOOZE, FRANK L. VINCENT, an individual,
FRANK L. VINCENT, doing business under the firm name and style of
Vincent's Dairy,

Appellees.

BRIEF FOR APPELLEE, FRANK L. VINCENT.

PETERS AND PETERS,

304 Broadway, Chico, California.

Attorneys for Appellee,

*Frank L. Vincent, an individual,
Frank L. Vincent,
doing business under the
firm name and style of
Vincent's Dairy.*

FILED

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Subject Index

	Page
Jurisdictional Facts and Pleadings.....	1
Statement of the Case.....	2
Argument	8
A. The pleadings present no facts warranting declaratory relief	8
B. The District Court had no jurisdiction.....	16
Conclusion	17

Table of Authorities Cited

Cases	Pages
American Building Maintenance Company v. Indemnity Insurance Company, 214 Cal. 608.....	16
Maryland Casualty Company v. Pacific Coal and Oil Company, 312 U. S. 270.....	12, 13

Codes and Statutes

Civil Code, Section 2778.....	14
Federal Declaratory Relief Act, Section 400.....	9

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BRIEF FOR APPELLEE, FRANK L. VINCENT.

JURISDICTIONAL FACTS AND PLEADINGS.

Appellant in its opening brief does not give jurisdictional facts and pleadings other than through statements contained throughout the brief under the different points raised. We do claim that the Circuit Court has no jurisdiction to decide the appeal for the reasons hereinafter stated; also we claim the District Court did not have power nor jurisdiction to try the case, and that its decision dismissing the complaint of plaintiff was in accordance with law.

STATEMENT OF THE CASE.

No statement of the case other than what may be gleaned from the different points made by appellant is contained in appellant's opening brief. Therefore we give a concise statement.

Upon August 22, 1942 plaintiff filed herein its complaint entitling the complaint "Complaint for Declaratory Relief determining the rights of the parties with reference to an indemnification policy". In this statement only the relevant portions of plaintiff's complaint will be referred to. In paragraph IV thereof plaintiff alleges as follows, to-wit:

"As a part of the insurance business which the plaintiff is authorized to conduct in the State of California is included that of issuing certain agreements known as 'Insurance Policies', for the purpose of indemnifying persons named in said policies, and protecting them under the conditions set out in said policies, from legal liability arising in connection with the maintenance, operation and ownership and driving of motor vehicles. In that connection the plaintiff had issued its policy No. 131186 to the defendant, Frank L. Vincent, as the 'named assured', for the policy year beginning May 22, 1941, and ending May 22, 1942, which policy covered a 1940 Dodge one-ton canopy truck, Motor No. T96-5704, for use in connection with a commercial retail milk delivery business operated by the defendant, Frank L. Vincent, under the name and style of Vincent's Dairy, a photostatic copy of said policy of insurance issued to defendant Frank L. Vincent, together with the amendatory endorsements thereto, is attached to this complaint

and marked Exhibit 'A', and incorporated herein by reference as though fully set forth within this paragraph."

In Paragraph V of said complaint it is substantially averred that the appellee herein, Frank L. Vincent was driving a 1940 Dodge truck described in the policy of insurance issued by plaintiff when such truck was involved in an accident with a Pontiac automobile driven by one Ray White at the intersection of 19th Street and Broadway Street in the City of Chico, County of Butte, State of California. Said paragraph V then avers that at the time of said accident one Vernon Booze, a minor of the age of approximately fourteen years and the son of the defendant L. L. Booze, was riding in a standing position on a step located on the back end of said 1940 Dodge truck which was driven and owned by the defendant Frank L. Vincent at said time, and that as a result of the collision of said Dodge truck driven by said Frank L. Vincent and said Pontiac automobile driven by said Ray White, said Vernon Booze received injuries and died on or about August 3, 1941.

Paragraph VI of said complaint alleges in substance that subsequent to said accident and on or about July 22, 1942 there was filed in the Superior Court of the State of California in and for the County of Butte case No. 18996 entitled "L. L. Booze, plaintiff, versus Frank L. Vincent, an individual, Frank L. Vincent, doing business under the firm name and style of Vincent's Dairy, et al., de-

fendants''. That the said Frank L. Vincent referred to in said accident is the Frank L. Vincent included in this case, and that copy of the summons and complaint in said State Court action was served upon the defendant Frank L. Vincent. That in said State Court action it is alleged in the complaint that L. L. Booze was the natural father of Vernon Booze, deceased, who, upon the date of his death was a minor of the age of approximately 14 years and that said minor met his death as a result of the *wilful misconduct* of Frank L. Vincent. Then follows in said complaint filed in the District Court of the United States, Northern District of California, Northern Division, a statement of damages alleged in the State Court action to have been suffered by L. L. Booze, the natural father of the said minor Vernon Booze, deceased.

The complaint filed in the District Court failed to state that also sued in said Superior Court action was one Ray White, the owner and driver of the automobile which had the collision with the Dodge truck driven by Frank L. Vincent. The said Ray White is not made a party in this action, namely the action filed in the said District Court.

The complaint filed in the District Court by plaintiff in paragraph VII alleges in substance that plaintiff notified the said Frank L. Vincent that it would not assume responsibility either for the defense of any lawsuit brought against him because of any claims on behalf of said Vernon Booze or on behalf of the heirs of said Vernon Booze, deceased, resulting

from the above described accident, and alleges it has refused to contribute anything to the settlement of said claim and has refused to assume the defense of the action, said action being Butte County action No. 18996.

The complaint filed in the District Court states in paragraph VIII that an actual controversy exists between plaintiff and defendant relative to whether or not the policy of insurance which plaintiff issued to the said Frank L. Vincent did or does cover any claims made by L. L. Booze or any other party in connection with the injury and death of the minor Vernon Booze, so as to establish responsibility against the plaintiff because of said contract of insurance.

Said paragraph VIII continues and alleges that plaintiff contends that the said Vernon Booze was an employee of the defendant Frank L. Vincent, and acting within the course and scope of his employment and as such employee the sole remedy of the said L. L. Booze for the death of his son is under the provisions of the Workmen's Compensation Act of the State of California, and further that the policy of insurance issued by plaintiff to the defendant Frank L. Vincent does not cover any claims made on account of the injuries and death of said Vernon Booze and that there is no obligation under said policy upon plaintiff to defend the action above described now pending in said Court, that is to say said Butte County action No. 18996, or to pay any judgment that might be rendered in said action. The policy of insurance issued by plaintiff to Frank L.

Vincent is attached to the complaint filed in the District Court as an exhibit and it is admitted to be a true copy of the policy in the case.

Such policy of insurance, which is policy No. 131186 of the plaintiff American General Insurance Company, Houston, Texas, was in force from the 22nd day of May, 1941 to the 22nd day of May, 1942. It is admitted by the pleadings that the policy covers the truck of the defendant Frank L. Vincent mentioned in plaintiff's complaint being a 1940 Dodge one-ton canopy truck, motor No. T96-5705 for use in connection with the commercial retail milk delivery business operated by the said defendant. This policy is quite lengthy and we deem it only necessary to quote parts thereof having a bearing upon this litigation.

Section I, Coverage A in said policy reads as follows, to-wit:

"To pay on behalf of the Insured (said Frank L. Vincent) all sums which the insured shall become obligated to pay by reason of the liability imposed upon him by law for damages, including damages for care and loss of services, because of bodily injury, *including death at any time resulting therefrom*, sustained by any person or persons, caused by accident and arising out of the ownership, maintenance or use of the automobile" (meaning the automobile or Dodge truck described in the policy). (Emphasis ours.)

Section II, Subdivision 2 of the policy reads as follows, to-wit:

"(2) Defense, Settlement, Supplementary Payments. It is further agreed that as respects in-

insurance afforded by this policy (under Coverages A and B) the Company shall (a) defend in his name and behalf any suit against the Insured alleging such injury or destruction and seeking damages on account thereof, *even if such suit is groundless, false or fraudulent*; but the Company shall have the right to make such investigation, negotiation and settlement of any claim or suit as may be deemed expedient by the Company; (b) pay all premiums on bonds to release attachments for an amount not in excess of the applicable limit of liability of this policy, all premiums on appeal bonds required in any such defended suit, but without any obligation to apply for or furnish such bonds, all costs taxed against the Insured in any such suit, all expenses incurred by the Company, all interest accruing after entry of judgment until the company has paid, tendered or deposited in court such part of such judgment as does not exceed the limit of the company's liability thereon, and expenses incurred by the Insured, in the event of bodily injury, for such immediate medical and surgical relief to others as shall be imperative at the time of the accident. The Company agrees to pay the amounts incurred under divisions (a) and (b) of this section in addition to the applicable limit of liability of this policy."

Under the provisions of said policy the legal limit of liability for "bodily injury liability" are as follows:

"\$10,000. each person and subject to that limit for each person.

\$20,000. each accident"

In the District Court Frank L. Vincent through his counsel moved to dismiss the action, primarily upon the following ground, to-wit:

“To dismiss the action because the Court has no jurisdiction of the subject matter of this action inasmuch as the complaint on file herein to which is attached the policy of insurance issued by plaintiff to the defendant Frank L. Vincent discloses that it is merely a policy to pay any judgment that may be rendered against Frank L. Vincent and/or Frank L. Vincent doing business under the firm name and style of Vincent’s Dairy, for personal injury caused by the operation of the 1940 Dodge one-ton canopy truck therein mentioned, and that no judgment has been rendered, and therefore no controversy can be had thereover until such judgment be rendered, and therefore the controversy in question does not exceed the sum of Three Thousand Dollars (\$3,000.00), and the Court is without the jurisdiction to entertain the same.”

Thereafter and upon the 25th day of February, 1943, the Judge of the said District Court granted the motion of the said Frank L. Vincent.

It is from this order of the District Court that appellant appeals.

ARGUMENT.

A. THE PLEADINGS PRESENT NO FACTS WARRANTING DECLARATORY RELIEF.

The opening brief of the appellant has been reviewed and we find no case cited which is applicable

to the instant case. Appellant "begs the question". It assumes, without proof, that the decedent Vernon Booze at the time in question was an employee of the defendant Frank L. Vincent. It argues that said Vernon Booze, being at the time of the accident an employee of the defendant Frank L. Vincent, the remedy of his father is provided exclusively by the Workmen's Compensation Act of the State of California and his father's suit in the Superior Court of the State of California in and for the County of Butte, being said case No. 18996, is entirely without merit and that said local Superior Court has no jurisdiction.

The Superior Court action referred to is one that comes within the purview of the policy. The most appellant's claim amounts to is that it is groundless, false or fraudulent. However, appellant in its policy agrees to defend any suit which came within the purview of the coverage "even if such suit is groundless, false or fraudulent". Also such suit comes within the purview of Section I, Coverage A of said policy and is therefore a suit which, if a recovery is had against the defendant Frank L. Vincent, appellant is obligated to pay up to the limits of its policy.

Appellant in its effort to bring this action within the jurisdiction of the Federal Court, seeks to rely upon the provisions of the Federal Declaratory Relief Act, Section 400 and particularly Paragraph I thereof which reads as follows, to-wit:

"(1) In cases of actual controversy the courts of the United States shall have the power, upon

petition, declaration, complaint or other appropriate pleadings to declare rights and other legal relations of any interested party petitioning for such declaration, whether or not further relief is or could be prayed, and such declaration shall have the force and effect of a final judgment or decree and be reviewable as such."

Appellee maintains that there is no controversy within the meaning of such Act, between the appellant and appellee. Appellant sets forth the terms of its policy of insurance, and appellee contends that the Butte County Superior Court action No. 18996 comes within the provisions of its policy to defend and in the event of an adverse judgment, to pay up to the limits of its policy. Appellant by pleading the policy, admits its due execution and delivery. There can be no controversy between appellant and appellee as to the fact that under the terms of this written contract of indemnification, appellant should defend the action and in the event of a judgment pay within the limits of the policy, for both of said parties to this action admit the due execution of the policy and its delivery, and under its terms that is what appellant agreed to do.

It is and has been elementary in the law of contracts not only in the State of California, but in all States of the Union, that an executed written contract is inviolable and the Courts have always respected the sanctity of such a document. In an instance such as this, to permit the appellant or any other insurance company, corporation or person, to

use the Courts as a means of defeating the plain provisions of their written contracts is opposed to public policy. If appellant could prevail in this case, then in other similar cases plaintiffs could prevail, and thus a precedent would be established which would effectively defeat not one but hundreds of thousands of insurance policies similar to this one, which is a standard type. In such cases, to avoid the cost of the defense of an action, and/or in the hope of securing a favorable determination in a federal or other Court, insurance carriers could defeat all such insurance policies and render them useless and void. One taking out an insurance policy such as this, believes that when an accident occurs within the purview of a policy upon which he has paid the premium, that he is entitled to have the action defended, and in the event of an adverse judgment, to have it paid within the limits of the policy. By substituting for such local trial and defense by the insurer, a proceeding such as is here contended for, the insurer could force upon the assured the expense of defending an action such as this, including the expense in the lower Court and also upon appeal, which is the case here, with the hope and aim that it might wear down the assured and also with the hope that it might prevail.

There can be no controversy in this action such as is contemplated by the provisions of the Federal Declaratory Relief Act, for the following reasons, to-wit:

1. There is no controversy over the terms of the policy, which terms explicitly provide that the ap-

pellant will defend the Superior Court action and pay any judgment rendered therein up to the limits of its policy.

2. No judgment has been rendered in the said Superior Court action and therefore there could be no controversy whether or not the appellant has to pay a judgment, and there could be no such controversy until a judgment is rendered.

The only case cited by appellant upon which appellee wishes to comment is that contained in the conclusion of appellant's brief, being the action entitled *Maryland Casualty Company v. Pacific Coal and Oil Company*, 312 U. S. 270.

In that case the petitioner Maryland Casualty Company issued a conventional liability policy to the insured Pacific Coal and Oil Company, and which contained the provision that the insurer would defend any action covered by the policy. While the policy was in force, a collision occurred between an automobile driven by one Orteca and a truck driven by an employee of the insured. Orteca brought an action in an Ohio State Court against the insured to recover damages for injuries sustained in the collision, and prior to its proceeding to judgment petitioner brought the above-named action for declaratory relief and in its complaint alleged that at the time of the collision the employee of the insured was driving a truck sold him by the insured on a conditional sales contract and for that reason that he was not an employee of the insured at such time and hence the company was under no obligation to defend the action brought by Orteca or pay under its policy in the event of an

adverse judgment against the insured. Orteca demurred to the complaint on the ground that it did not state a cause of action against him, and said demurrer was sustained in the District Court and was affirmed in the Circuit Court of Appeals. The Supreme Court granted certiorari to resolve the conflict with other Circuit Courts of Appeal and set forth that the question involved was whether the petitioner's allegations were sufficient to enable it to the declaratory relief prayed for and stated "this raises the question whether there is an 'actual controversy' within the meaning of the Declaratory Judgment Act".

In deciding the question the Supreme Court of the United States reversed both the District Court and the Circuit Court of Appeals and stated as follows:

"That the complaint in the instant case presents such a controversy is plain. Orteca is now seeking a judgment against the insured in an action which the latter claims is covered by the policy, and secs. 9510-3 and 9510-4 of the Ohio Code (Page's Ohio General Code, Vol. 6, secs. 9510-3, 9510-4) *give Orteca a statutory right to proceed against petitioner by supplemental process and action if he obtains a final judgment against the insured which the latter does not satisfy within thirty days after its rendition.*" (Emphasis ours.)

The *Maryland Casualty Company* case is distinguishable from the instant case. In the instant case there is no statute granting the plaintiff in the Superior Court action the right to proceed against the

appellant herein by supplemental process and action if he obtains a final judgment against the insured which the latter does not satisfy within thirty days after its rendition. Under the law of the State of California if there is a valid policy and the action is one within its provisions, and the insurer fails to pay, it may be sued, but this is in a separate and distinct action, *and is not a supplemental process and action*, such as is granted under the laws of the State of Ohio.

Apparently the Ohio statute gives the plaintiff in personal injury actions a summary right against an insurer of the defendant, whereby in the same action and after the expiration of a certain time, such plaintiff, if successful in securing a judgment, may proceed directly against the insurer. This would be similar to certain statutes in the State of California. If a judgment is rendered against a defendant who claims himself insured under a policy of indemnification when demand is made upon the insurer for the payment of a judgment rendered, an insurer may deny liability; then and then only would an actual controversy arise in respect to the matter. In fact an insurer which deems itself not liable under the terms of the policy has many ways of protection: He may defend under a non-waiver of rights agreement or under a reservation of rights agreement, or may bring a declaratory relief action.

The California law of indemnity contracts is found in Section 2778 of the Civil Code and reads as follows, to-wit:

“Par. 2778. Rules for Interpreting Agreement of Indemnity. In the interpretation of a contract of indemnity, the following rules are to be applied, unless a contrary intention appears:

1. Upon an indemnity against liability, expressly, or in other equivalent terms, the person indemnified is entitled to recover upon becoming liable;
2. Upon an indemnity against claims, or demands, or damages, or costs, expressly, or in other equivalent terms, the person indemnified is not entitled to recover without payment thereof;
3. An indemnity against claims, or demands, or liability, expressly, or in other equivalent terms, embraces the costs of defense against such claims, demands or liability incurred in good faith, and in the exercise of a reasonable discretion;
4. The person indemnifying is bound, on request of the person indemnified, to defend actions or proceedings brought against the latter in respect to the matters embraced by the indemnity, but the person indemnified has the right to conduct such defenses, if he chooses to do so;
5. If, after request, the person indemnifying neglects to defend the person indemnified, a recovery against the latter suffered by him in good faith, is conclusive in his favor against the former;
6. If the person indemnifying, whether he is a principal or a surety in the agreement, has not reasonable notice of the action or proceeding against the person indemnified, or is not allowed to control its defense, judgment against the latter is only presumptive evidence against the former;

7. A stipulation that a judgment against the person indemnified shall be conclusive upon the person indemnifying, is inapplicable if he has a good defense upon the merits, which by want of ordinary care he failed to establish in the action. (Enacted 1872.)”

See also

American Building Maintenance Company v. Indemnity Insurance Company, 214 Cal. 608.

It is plain therefore that no actual controversy exists between appellant and appellee Frank L. Vincent for as yet no judgment has been rendered against the appellee Frank L. Vincent; in fact he may win the Superior Court action, and it is our belief he will, but this is merely belief. There can be no controversy over paying a judgment which has not been rendered, and which may in fact never be rendered.

B. THE DISTRICT COURT HAD NO JURISDICTION.

We comprehend the law of Federal Court jurisdiction to be a diversity of citizenship and the controversy involves more than \$3000.00 exclusive of interest and costs. There is no controversy here involving more than \$3000.00, and cannot be. There is no judgment rendered in the Superior Court action, and as stated hereinbefore in this brief, there can be no controversy over the payment of any judgment until one is rendered. A judgment may never be rendered in said Superior Court action or it may

be entered in a sum less than \$3000.00, and hence there is no proof of jurisdiction.

Again there is nothing in the record to show the cost of defending the action will amount to more than \$3000.00, or even will approximate such sum. This Court may take notice as a matter of common knowledge, that the cost of the defense of an action such as Butte County Action No. 18996 would not and could not exceed \$1000.00. Hence there is no jurisdiction in the District Court.

CONCLUSION.

For the reasons set forth above it is respectfully submitted that the order of the District Court dismissing be affirmed.

Dated, Chico, California,

December 31, 1943.

Respectfully submitted,

PETERS AND PETERS,

Attorneys for Appellee,

Frank L. Vincent, an individual, Frank L. Vincent, doing business under the firm name and style of Vincent's Dairy.

No. 10,412.
IN THE
United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

AMERICAN GENERAL INSURANCE COM-
PANY, a corporation,

Appellant,

vs.

L. L. BOOZE, FRANK L. VINCENT, an
individual, FRANK L. VINCENT, doing
business under the firm name and style
of Vincent's Dairy,

Appellees.

APPELLANT'S CLOSING BRIEF.

FORREST A. BETTS,
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TOPICAL INDEX.

	PAGE
Preliminary statement	1
Reply argument to statement contained in appellee's brief under the heading "Statement of the Case".....	3
Answering appellee's "Argument"	8
(1) The question of whether or not the facts alleged war- rant declaratory relief.....	8
Conclusion	10

TABLE OF AUTHORITIES CITED.

CASES.	PAGE
Commercial Casualty Ins. Co. v. Humphrey, 13 Fed. Supp. 174	7
Curaco Trading Co. v. Wm. Stake & Co., 2 F. R. D. 308.....	8
Maryland Casualty Co. v. Pac. Coal & Oil Co., 312 U. S. 270....	10
Maryland Casualty Co. v. Texas Fireproof Storage Co., 69 S. W. (2d) 826.....	3
Merchants Mut. Cas. Co. v. Drown, 199 Atl. 568.....	11
Ocean Accident & G. Corp. v. Washington Brick & T. C. Co., 148 Va. 829, 139 S. E. 513.....	6
Sun Indemnity Co. v. Dulaney, 89 S. W. (2d) 307.....	4
Tahir Erk v. Glenn L. Martin Co., 116 Fed. (2d) 865.....	8

TEXTBOOKS.

7 Appelman, Insurance Law and Practice, Sec. 4255.....	4
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L. L. BOOZE, FRANK L. VINCENT, an individual, FRANK L. VINCENT, doing business under the firm name and style of Vincent's Dairy,

Appellees.

APPELLANT'S CLOSING BRIEF.

Preliminary Statement.

The appellee, Frank L. Vincent, has greatly amplified the factual background of this case. It was our feeling that the opening brief sufficiently presented the matter to the Court, but certainly, with appellee's reply, there should be no question of these facts.

Our complaint in the court below alleges that Vernon Booze at the time of his death was an employee of the defendant Frank L. Vincent, acting within the scope of his employment, and that the death was occasioned on the 3rd day of August, 1941, as the result of an automobile action

at an intersection, involving the vehicles owned and driven respectively by Frank L. Vincent and Ray White.

Likewise it should now appear that there is no conflict over the proposition that a case has been brought in the State Court in California, by the father of Vernon Booze, and that this case is predicated upon the claim of wilful misconduct—that is to say, is predicated upon the claim that Vernon Booze was a guest, riding on the automobile of Frank L. Vincent as such, at the time the accident occurred.

The controversy therefore necessarily arises out of the conflicting claims of appellant, American General Insurance Company, and appellee. If it is true that deceased was a guest, rather than an employee, of Frank L. Vincent, then American General Insurance Company owes to Frank L. Vincent a defense in the State Court case. On the other hand, if deceased was an employee of the defendant Vincent, the policy of American General does not apply—in fact, cannot lawfully apply—because it is not a workmen's compensation policy, and further because of the fact that such coverage is specifically excluded.

In this closing presentation the briefer is attempting to follow the order in which the statements are presented in the reply brief of Frank L. Vincent.

Reply Argument to Statement Contained in Appellee's Brief Under the Heading "Statement of the Case."

Under the heading of "Statement of the Case," appellee sets up the general insuring clause, Section I, Coverage A. If, for the minute, we exclude the question of whether or not it would be lawful under our Workmen's Compensation Act to issue such a policy covering an employee, and if we then were to assume that the general insuring clause was the only insuring clause in the policy, there might be something to be said for the contention of appellee. However, the position thus taken by appellee entirely fails to allow for the additional rule of interpretation, to the effect that specific exclusions stated in the policy are in limitation of the general insuring clause. That is to say, as to any situation which is expressly excluded from coverage by the terms of the policy, that express exclusion is a limitation on the general insuring clause.

Thus, in the case of *Maryland Casualty Co. v. Texas Fireproof Storage Co.*, 69 S. W. (2d) 826 (Texas Civ. App. 1934), in considering a like problem it was held in the lower court that exclusion clauses, which if interpreted in their normal meaning would have limited the right to recovery under the general insuring clause, were repugnant to the general terms of the policy, and therefore inoperative. This decision was reversed on appeal and, in discussing the matter, the Court states at page 828:

"The clause in the policy sued on which obligated appellant to indemnify appellee, as the same has been hereinbefore recited, was expressly made 'subject to the limitations, conditions and exceptions hereof.' Said obligation, so far as applicable here, was to indemnify

appellee against liability for accidents caused by certain of its employees in the course of their employment occurring elsewhere than on the particular premises described in the policy. It was general in its terms, and unless limited by subsequent provisions, embraced all accidents of every kind occurring off the premises, if caused by such employees in the discharge of the duties of their employment. Clearly, the purpose of paragraphs (6) and (7) of subdivision II was to except from the obligation created by the policy liability for damages arising out of accidents of the particular kinds and classes specified therein. Liability for all other kinds or classes of accidents except those so enumerated remained within the original obligation. Since such obligation was both conditional and general, such exceptions are not repugnant to the promise of indemnity contained therein but are valid limitations thereof. The court erred in holding them invalid."

See also *Sun Indemnity Co. v. Dulaney*, 89 S. W. (2d) 307 (Ky. App. 1936), to the effect that the parties have the right to insert such limiting agreements as they desire, as long as the limitation is a lawful one.

A good general statement of the principles involved is contained in Section 4255 of Appelman, 7 Appelman Insurance Law and Practice, as follows:

"Where the obligation is expressed in the policy in general terms, it has been held that the insurer may insert as many clauses excepting particular risks from the general coverage as it sees fit, notwithstanding its obligation is materially limited by such exclusions.
. . ."

Thus, under "Exclusions," Section (e), the wording is as follows:

"This policy excludes any obligation of the Company . . . (e) Under Coverage A, for such bodily injury to or death of any employee of the Insured while engaged in the business of the Insured, other than domestic employment, or in the operation, maintenance or repair of the automobile, or to any obligation for which the insured may be held liable under any Workmen's Compensation;"

It is apparent from this wording of the Policy that the General Insuring Clause relied upon by appellee's counsel is limited by exclusion (e) so as to expressly not cover the deceased, if the deceased was for any reason an employee, and, thus, covered by the Workmen's Compensation Act at the time of his death.

Next, on pages 6 and 7 of appellee's reply brief, reliance is made on Section II, Subdivision 2 of the policy, and we judge, from the italicised parts thereof, that counsel is claiming that, no matter whether there be or be not coverage under the policy, the mere fact that the claim of the plaintiff against the assured is groundless or false or fraudulent, gives the defendant in the state court a right to a defense under the policy of the Company. The trouble with this contention is that it has been expressly denied by judicial decision. This very same contention was presented, as we indicated in our opening brief, in the case of *Ocean Accident & G. Corp. v. Washington Brick*

& *T. C. Co.*, 148 Va. 829, 139 S. E. 513, where at page 517 of 139 S. E. the court specifically said that the insured was claiming that the insurer was bound to defend all suits and action, although they were "wholly groundless, false, or fraudulent." In that case the court specifically denied the applicability of the rule contended for here by appellee. The right to have the Company either defend or pay judgment, if any be rendered, must first have, as its foundation, coverage under the policy. To establish any other rule would be to unfairly burden the particular type of insurance involved with more than its share of insurance obligation—that would be the effect of a ruling which would deny to the Company the right to claim that there was no coverage and that therefore no obligation ever arose to perform any of the covenants of the policy. If the accident occurred under circumstances where coverage did exist, or if the facts alleged were such as to bring the case within the foundational coverage of the policy, then, and then alone, would the Company be required to defend, even though the claim might be fraudulent, or might be false, or might be entirely groundless.

On page 8 of appellee's reply brief—still under "Statement of the Case," counsel seems to present the contention that, since no judgment has been rendered, it cannot now be said that the controversy is one involving a claim in excess of \$3000.00, so as to bring it within the general jurisdiction of the court. Here again, the trouble with appellee's contention is that the case law has decided this issue against him. In our opening brief, we pointed out

that in the case of *Commercial Casualty Ins. Co. v. Humphrey*, 13 Fed. Supp. 174, at 178, the court decided this issue by saying:

“The test of jurisdiction is not what Pierce (Booze) may claim against plaintiff, but the maximum amount for which plaintiff may be liable under the policy.” (Parenthetical insertion added.)

We cannot pass the opening statement without noting the comments on page 4 of appellee’s reply brief, to the effect that Ray White, the alleged joint *tort feasor* in the state court action, is not here made a party. We assume that counsel is attempting to plead that Ray White is a necessary party. He does not, however, attempt to answer the facts set out in the opening brief, and the argument thereon, namely, that he, Ray White, has no interest of any sort in the policy of American General. As a joint *tort feasor*, he is not abused—in the legal sense of the word—by any result which may occur in this Declaratory Relief action. He may be interested in the *outcome* of this case from a purely practical point of view—that is, practical to him, *but he has* no legal interest in that outcome! Declaratory Relief cases provide for bringing in “interested parties.” Some parties are necessary; others have only a legal interest in the outcome. It is for this reason that we bring into court the defendant Booze, who is the plaintiff in the state court action. He is the typical example of an interested party to the action. Mr. White does not belong in this case.

Answering Appellee's "Argument."

(1) THE QUESTION OF WHETHER OR NOT THE FACTS ALLEGED WARRANT DECLARATORY RELIEF.

In the first paragraph of this portion of appellee's reply brief a most peculiar statement appears—namely, that appellant "begs the question," because it assumes, "without proof" that the decedent Vernon Booze at the time in question was an employee of the defendant Frank L. Vincent." It is, of course, fundamental that when counsel comes into court, moving for the dismissal of the cause, as was done here, upon the ground that the facts stated give no jurisdiction to the court, the facts alleged in the declaration or complaint must be accepted as true in deciding that motion. In other words, the court must assume, for the purpose of the motion, that our allegations are true. It is for the purpose of proving them to be true, in the face of any controversion thereof, if any there may be, that we institute this action.

See:

Tahir Erk v. Glenn L. Martin Co., 116 Fed. (2d) 865 (C. C. A. 4th, 1941);

Curaco Trading Co. v. Wm. Stake & Co., 2 F. R. D. 308 (U. S. C. N. Y., 1941).

The next paragraph, on page 9 of the reply brief, concerning fraudulent claims, we have already answered.

The next contention first makes its appearance on page 10 of the reply brief. It seems to be substantially this: that since we admit that we executed and delivered the policy we are, *a fortiori*, required to defend the state court action, and pay the judgment, if any be rendered.

The discussion on pages 10 and 11 are so entirely void of any substance that it is with difficulty that it is resolved into any contention whatever. However, it appears to be predicated upon the proposition that when an insurance company issues a policy, it has no right to have the policy interpreted so that a legal adjudication of its meaning may be had. Such a contention is so foreign to logic that we think it needs no answer in this brief. We do again state that we admit, and have always admitted, the execution of the policy, and the fact that it was in full force and effect at the time the accident occurred. The question we are seeking to have determined is: What was that full force and effect? What is the legal interpretation to be given to the policy insofar as it relates—if it does relate at all—to the claim of the heirs of the deceased, Vernon Booze?

The very statement of counsel on these pages establishes, probably as strongly as we have already stated it, that there is a controversy between American General on the one hand, and Booze and Vincent on the other, concerning whether or not there is coverage. This coverage, if it exists, would subject American General to (1) immediately establish sufficient reserves to cover the possible judgment which *might* be rendered against Vincent; (2) establish reserves for payment of necessary additional investigation and defense of Mr. Vincent; (3) the payment of those costs and expenses as they became due; and (4) the payment of any final judgment which might be rendered against Vincent and in favor of Booze. It may be entirely improbable that such a judgment would reach the sum of \$10,000.00, but that is "the maximum amount for which plaintiff may be liable under the policy" and, therefore, becomes the test of jurisdiction.

We are unable to follow the argument of counsel for appellee concerning the inapplicability of the case of *Maryland Casualty Co. v. Pac. Coal & Oil Co.*, 312 U. S. 270. We see no substantial difference between the provisions of the Ohio Statute and our own. Unless there was a failure of coverage under our policy—the very thing for which we are contending here—the plaintiff would have an immediate incontrovertible action against American General within the limits of American General's policy, predicated upon any final judgment entered against Frank L. Vincent.

Conclusion.

Paraphrasing some of the cases cited previously, there can be no question but that the cause of action in the state court was one for damages for wrongful death arising out of personal injuries, and also that it affirmatively appears, from the allegations of our complaint, that the injuries from which the death arose, were sustained out of, and in the course of the employment of the deceased; that the cause of action is between employer and employee; that the exclusive jurisdiction of the Industrial Accident Commission over such claim is well settled; and that the establishment of such a relationship entirely removes from consideration, by any of the parties in the state court, the automobile policy of the plaintiff American General herein. The purpose of Declaratory Relief actions is to have these matters determined before the risk is matured—before the coercion arises—with the enlightening help of an interpretation upon policy matters of this sort, all litigants in the state court will have a much clearer picture of what is before them. The hope of eventually pushing American General into the corner for some contribution will have faded, and with it may disappear all of the litigious hopes of

plaintiff in the Superior Court. If this is true, it is a desirable result! Litigation predicated purely upon the supposition that an insurance company will pay something to dispose of a groundless claim is litigation of which we are well rid.

The right of judicial declaration of either liability or non-liability, predicated upon the happening of an accident and the issuance theretofore of an indemnifying policy, is a well established declaratory right. The demand that the insurer defend an action warrants an appeal to the court for a declaration of non-liability, where there is no coverage. If this were not true there is hardly a cause of action brought in our Superior Court but that the plaintiff might allege that, as a part of the transaction, the defendant was insured and that there is liability under the indemnity policy. Even in contract actions such allegations could be made and, if appellee's contention is right, the defendant would then have to appear and defend, even though the complaint was entirely foreign to the problem or matter for which the indemnifying policy was originally issued.

We submit that all of the cases established the right of appellant to a judgment predicated upon our ability to prove the allegations of our complaint. The issue was specifically determined in the case of *Merchants Mut. Cas. Co. v. Drozen*, 199 Atl. 568, and we submit that there is in substance no attempt on the part of appellee to answer the decisions which we have set out in our opening brief and in this brief in substantiation of our right to a declaration on the terms of the policy.

Respectfully submitted,

FORREST A. BETTS,
Attorney for Appellant.

